S. HRG. 101-207

S. 863 AND S. 851

HEARING

BEFORE THE

SUBCOMMITTEE ON RURAL ECONOMY AND FAMILY FARMING

OF THE

COMMITTEE ON SMALL BUSINESS UNITED STATES SENATE

ONE HUNDRED FIRST CONGRESS

FIRST SESSION

ON

TO ASSESS THE IMPACT OF S. 863, THE RURAL ACCESS TO CAPITAL ACT OF 1989, AND S. 851, THE SMALL BUSINESS REVITALIZATION ACT OF 1989

JUNE 9, 1989

Printed for the use of the Committee on Small Business

U.S. GOVERNMENT PRINTING OFFICE

21-344 WASHINGTON : 1989

For sale by the Superintendent of Documents, Congressional Sales Office
U.S. Government Printing Office, Washington, DC 20402

S721-12.

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HEARING DATE

June 9, 1989

Morning session 1

S. 863, THE RURAL ACCESS TO CAPITAL ACT OF 1989, AND S. 851, THE SMALL BUSINESS REVITALIZATION ACT OF 1989

FRIDAY, JUNE 9, 1989

U.S. SENATE,
SUBCOMMITTEE ON RURAL ECONOMY
AND FAMILY FARMING,
COMMITTEE ON SMALL BUSINESS,
Washington, DC.

The Subcommittee met, pursuant to notice, at 9:40 a.m., in room SR-428A, Russell Senate Office Building, Hon. Max Baucus (Chairman of the Subcommittee) presiding.

STATEMENT OF HON. MAX BAUCUS, A U.S. SENATOR FROM THE STATE OF MONTANA

Senator BAUCUS. Welcome to this morning's hearing.

There is an economic crisis in rural America today. Rural businesses, hospitals, and schools across the country are being forced to close their doors.

Young, educated entrepreneurs are having to leave their families in rural areas in order to find jobs in more populated urban centers. Since 1980, Montana alone has suffered a net population loss of over 29,000 people.

Since 1980, this country has developed a "Swiss cheese" economy. We have prosperous, growing urban areas—especially on the coasts.

But we have holes in between. Those holes are generally located in sparsely populated areas which are dependent on natural resources for their economic base.

We, in Congress, must work to fill in those holes. We must ensure that rural areas prosper along with urban areas.

Daniel Webster put it well during his famous debate with Senator Hayne of South Carolina. Hayne argued that citizens of the South should not pay for public improvements in the West, because they derived no benefit from them. Webster replied:

> In our contemplation, States of the South and Southwest are parts of the same country. States, united under the same general Government, having interests, common, associated, intermingled * * * we do not impose geographical limits to our patriotic feeling or regard; we do not follow rivers and mountains, and lines of latitude, to find boundaries beyond which public improvements do not benefit us.

We need to revive this notion. That we're all in this together. "E pluribus unum"—one out of many. We must not impose geographic limits on our concern for the economic well-being of American fam-

ilies. People shouldn't have to pack up and move to the sunbelt to make a decent living.

In order to equalize opportunities for those people and businesses who want to locate in rural areas, we need to provide access to some basic tools of modern business—the kind of tools that urban businessmen take for granted. One such necessary tool for small rural businesses is the formation of capital—capital that is rapidly disappearing from rural America. Deregulation of the banking industry is draining capital from rural to urban centers, so that smalltown entrepreneurs can't get a loan to start up, for fix up, or expand their mainstreet businesses.

Today, we will hear comments on two bills designed to make capital more readily available in rural areas. My legislation, S. 759, the "Rural Access to Capital Act of 1989," and Senator Boschwitz' legislation, S. 1051, the "Small Business Rural Revitalization Act."

I look forward to your comments.

[The prepared statements of Senators Bumpers and Dixon follow:]

STATEMENT OF SENATOR DALE BUMPERS
SUBCOMMITTEE ON THE RURAL ECONOMY AND FARMING FARMING
JUNE 9, 1989

I want to commend both Senator Baucus, Chairman of the Subcommittee on the Rural Economy and Family Farming, and Senator Boschwitz, our Ranking Republican, for the time and effort which they have put into drafting the two bills before the Committee this morning. Senator Baucus has also chaired numerous hearings both in Washington and in his home state during the last two years. He has become one of the Senate's experts on problems facing rural America, and especially the Western States.

The most crucial problem facing rural America, in my view, is access to capital for business growth. Various regions of the country have their own regional difficulties--whether it be transportation, communications, health care or many others--but the problem of capital seems to be a common thread across many issues and across state boundaries. To address the problems facing the Mississippi Delta region, last year I introduced and saw enacted the Mississippi Delta Development Commission. This Commission's study and recommendations are only a first step, but I strongly commend this approach to other regions which may have their own unique set of problems.

Nonetheless, the availability of capital is a universal problem in rural America. Both of the bills before the Committee address this issue, but I am doubtful that either of them or many other well-intentioned measures will be adequate to meet the needs of our increasingly distressed rural communities. During the last Presidential campaign, one issue which was repeatedly raised by Governor Dukakis and Senator Bentsen, and which I believe was never refuted or doubted, was the growing disparities between the City and the Country, especially between the East and West Coasts

and the heartland. The states between the Rockies and the Appalachians have enjoyed only a small fraction of the economic growth since 1982, while unemployment has become a thing of the past in the thirteen states along the Eastern Seaboard plus California.

Incidentally, it is both appropriate and necessary for the United States Senate to address this issue. As important as the proportional representation of the House is, only in the Senate is it guaranteed that states which are hurting will have equal voice with the affluent. This surely explains why there is more interest in the rural issue in the Senate.

The Majority and Minority Leaders have appointed a bipartisan task force to develop comprehensive legislation to address the manyfold problems facing our smaller cities and towns. I have joined this task force and I have forewarned my colleagues that our task may be long and difficult. One thing is clear to all who have studied our economy in recent years: The preponderance of our economic growth over the last ten years has come from small business. The entrepreneur has once again overtaken the massive corporation as the engine of economic growth.

So, whatever Congress and the Executive do, we should make every effort to help small businesses grow. Growth requires adequate capital, and it requires a cooperative and supporting relationship between business owners and government as well as between business owners and their employees. We are not adversaries, and we cannot hope to compete with our well organized and unified competitors abroad if we do not all play on the same team.

I look forward to the comments from today's witnesses on these pressing problems and the ideas which have been suggested as solutions.

JUNE 9, 1989

STATEMENT BY ALAN J. DIXON

SMALL BUSINESS COMMITTEE

RURAL ECONOMY AND FAMILY FARMING SUBCOMMITTEE

HEARING ON RURAL DEVELOPMENT

MR. CHAIRMAN, WE ARE HERE TODAY TO EXAMINE LEGISLATION IN THE AREA OF RURAL DEVELOPMENT. I COMMEND THE CHAIRMAN FOR HOLDING THIS HEARING ON THIS VERY IMPORTANT SUBJECT. THE VERY FACT THAT THIS SUBCOMMITTEE IS THE LARGEST ESTABLISHED BY THE SMALL BUSINESS COMMITTEE INDICATES OUR STRONG INTEREST IN AND COMMITMENT TO THE NEEDS OF RURAL AMERICA.

TODAY WE WILL EXAMINE LEGISLATION THAT OFFERS THE MEANS FOR SMALL BUSINESSES TO CONTRIBUTE IN THE REBUILDING OF OUR RURAL COMMUNITIES. BY VIRTUALLY EVERY MEASURE, RURAL AMERICA IS POORER THAN THE NATION AS A WHOLE. PER CAPITA INCOME IN RURAL AREAS IS LESS THAN 60 PERCENT OF THE AVERAGE IN URBAN AREAS. FOR THE FIRST TIME IN DECADES, RURAL UNEMPLOYMENT IS HIGHER THAN THAT OF OUR URBAN AREAS. ONE THOUSAND RURAL COUNTIES CAN BE SINGLED OUT AS THE HARDEST HIT - SOME WITH MORE THAN 55 PERCENT OF THEIR RESIDENTS IN POVERTY, AND WITH RURAL UNEMPLOYMENT RATES 50 PERCENT HIGHER THAN THE NATIONAL AVERAGE.

RURAL AMERICA IS FACING SEVERE ECONOMIC DECLINE. UNLIKE URBAN AREAS, THE ECONOMIES OF RURAL COMMUNITIES ARE NOT DIVERSIFIED, MAKING THEM VULNERABLE TO ECONOMIC DOWNTURN, AND LESS ABLE TO TAKE ADVANTAGE OF RECOVERY. SIMULTANEOUSLY, RURAL AREAS HAVE FACED DECLINING SUPPORT FROM THE FEDERAL GOVERNMENT. RURAL AMERICA IS CAUGHT IN A VISE. THE SITUATION DEMANDS ATTENTION BEFORE CONDITIONS WORSEN FURTHER.

OUR SESSION HERE TODAY IS A HOPEFUL SIGN. I LOOK FORWARD TO HEARING FROM THE DISTINGUISHED WITNESSES BEFORE US TO GAIN INSIGHT AS TO HOW SMALL BUSINESSES CAN CONTRIBUTE TO THE REVITALIZATION OF RURAL AMERICA. THANK YOU, MR. CHAIRMAN.

Senator BAUCUS. Senator Boschwitz is on his way and will be here fairly soon. I am wondering at this point whether any other Members of the Subcommittee have short, brief, pithy, succinct statements they wish to make?

Senator Pressler.

STATEMENT OF HON. LARRY PRESSLER, A U.S. SENATOR FROM THE STATE OF SOUTH DAKOTA

Senator PRESSLER. I do not want to go ahead of any of my colleagues, Mr. Chairman, but I have a statement.

I thank you for drawing this Committee's attention to the special needs of rural America. Considering the composition of this Committee and the strong interest shown in the Rural Economy and Family Farming Subcommittee, I think this will be a productive session of Congress for rural America.

The question of survival can often be translated into a question of access. To be competitive in today's business environment, one must have access to reliable and affordable transportation, a strong selling point for the Essential Air Service Program, dependable communication systems, a quality workforce, and many other things.

Today's hearing focuses on another point of access, access to capital. To put things in perspective, I would like to highlight the role of small businesses in South Dakota. Of the 19,491 business establishments in my State, 19,473 are small businesses with fewer than 500 employees. That amounts to 99.9 percent of all the businesses in my State are small businesses.

These businesses have created nearly 30,000 new jobs in my State in the last 6 years. Business starts are increasing, and business bankruptcies are decreasing. Things are looking up in South Dakota, but there needs to be additional incentives and improved access to capital for these businesses in order to sustain this positive outlook.

I commend my colleagues, Senators Baucus, Boschwitz and others for looking out for rural America in the Rural Revitalization Act and Rural Access to Capital Act. I look forward to hearing today's testimony and working with the Members of this Subcommittee to improve rural America's ability to compete in business.

Senator BAUCUS. Thank you very much, Senator.

Senator Grassley.

STATEMENT OF HON. CHARLES E. GRASSLEY, A U.S. SENATOR FROM THE STATE OF IOWA

Senator GRASSLEY. Mr. Chairman, I thank you very much for holding the hearing.

The issue of rural development is a difficult one to address effectively because there is no real consensus yet on the roots of the problem or the means to a solution. However, there is agreement on some aspects of the issue. Diversification is a key to development. New capital is necessary to process raw materials from agriculture as well as develop new commercialized, agriculturally-based products.

As the Congress works toward creating economic opportunity and improving the quality of life in the rural heartland, it is important that we examine every possible method of accomplishing our goal. I see the Rural Access to Capital Act and the Small Business Rural Revitalization Act as positive steps toward providing the equity capital and the gap financing that is necessary if we are to achieve an effective rural revitalization.

In fact, to diversify our economy means that we have to have jobs created that are not so totally dependent upon agriculture.

I want to thank each of the witnesses for being here today, and I look forward to your testimony as we consider the legislation presently before the Subcommittee.

I would also ask permission, Mr. Chairman, to be able to include some questions for answers in writing since I am not going to be here for the entire meeting.

Senator BAUCUS. Without objection, they will be included.

Before I turn to my colleague, Senator Burns, I wanted to thank him for joining me in conducting a recent hearing in Livingston, MT, on this very question. My bill along with that of Senator Boschwitz and others were the subjects of that hearing.

Senator, we are happy to have you here this morning.

STATEMENT OF HON. CONRAD BURNS, A U.S. SENATOR FROM THE STATE OF MONTANA

Senator BURNS. Thank you, Mr. Chairman. It was nice to be in Montana and hear from some folks out there. I again want to thank you for drawing our attention to this. All you have to do is travel down through rural America, and you will find out that we have some big problems out there.

We are here today to talk about one of the most important aspects of business development, and that is capital formation. We heard from several fellow Montanans who testified that small business is having a hard time finding it. The bills we are discussing today are aimed at giving small business more capital options.

I think utilizing certified development companies to loan money locally is an excellent idea, and I am glad that both bills utilize this important tool. I am also looking forward to hearing from the witnesses today, because I think they will probably enlighten us on how it can be used even better.

I also hope that the final bill includes encouragement for business incubators. There are currently two of them operating in Montana. They are operating very well, and we certainly want to see them expanded.

In conclusion, Mr. Chairman, I want to say that in reviewing this issue I am struck by the number of programs that already exist to help small business. I think it is important that we take a look at the current programs and make sure that they take into account the needs of rural America. Senator Boschwitz's bill is a step in that direction, and I commend him on his efforts.

I am really looking forward to hearing the witnesses today, and I want to thank them for taking time out of their busy schedule to come before this Subcommittee and help us craft a bill which we think will be best for small business, keeping in mind bottom line,

whether you can form the capital or not, can they make a profit. Is it sometimes the Federal Government and it's rules and regulations and taxes that actually keep them from making a profit or moving forward in the rural area.

We must never forget just exactly what makes this great free enterprise system tick. That is the bottom line.

Thank you, Mr. Chairman.

Senator BAUCUS. Thank you, Senator.

Senator Wallop.

STATEMENT OF HON. MALCOLM WALLOP, A U.S. SENATOR FROM THE STATE OF WYOMING

Senator WALLOP. Mr. Chairman, I have a statement that, among other things, congratulates and thanks you which I will put into the record. It does express a few reservations about the bills.

I especially think that we should strive for some common definition, one concept to the other. In general, I think it is the right track to undertake, and I am happy to be here this morning.

[The prepared statement of Senator Wallop follows:]

STATEMENT BY SENATOR MALCOLM WALLOP
BEFORE THE SENATE COMMITTEE ON SMALL BUSINESS
REGARDING RURAL DEVELOPMENT LEGISLATION, S. 1051 AND S. 863
FRIDAY, JUNE 9, 1989

Mr. Chairman, I appreciate your holding this hearing today and would also like to express my gratitude to the ranking minority member, Senator Boschwitz, for his efforts to bring rural development initiatives to the fore of the legislative agenda of the Small Business Committee. Although my own rural State of Wyoming continues to have below average income growth, several small-business indicators show some signs of improvement. Proprietorship income increased in 1988 while the number of business bankruptcies and failures declined. I think it is important to our national economy that we do what we can to ensure that small businesses in rural areas continue to grow and expand. While I believe the two bills we are considering here today make valid attempts to revitalize rural America, I do have a few reservations about them which I will share with you.

In my view, the legislation introduced by Senator Boschwitz, the Small Business Revitalization Act, is positive in concept, but I believe the provisions in the bill need to be more clearly defined. For starters, the definition of rural -- areas populated with 50,000 or less -- should be uniform throughout all federal agencies which deal with economic and rural development issues.

The definition in this bill differs from that in S. 863 and in turn both these definitions of rural are not consistent with the provisions of Public Law 100-590 which we adopted last year to deal with improved access to capital for rural small businesses.

S. 1051 also creates a new section 507 revolving loan fund authorized to make small business loans of up to $100,000. Funding for this program would come out of the existing 504 loan program which is normally used for construction, etc., but the provision does not specify exactly what the loans could be used for, such as working capital, etc. I would welcome the opportunity to work with my colleagues in an attempt to provide some focus to this provision that would foster business growth.

I am also concerned that the provision which would authorize SBA matching grants to economic development authorities for the creation of business incubators provides that the money for incubators would come from the existing 7(j) program. The FY 90 budget resolution provides no funds for the 7(j) program, so you would have to find the money to fund this provision.

While I believe the basic thrust of S. 863, the Rural Access to Capital Act of 1989, to encourage private investments in rural business is also commendable, I do have strong reservations about it due to the potential costs of the bill -- estimated to be some $50 million. I might also point out that the existing 7(a) loan program provides many of the benefits contained in S. 863 without establishing costly new programs with substantial administrative costs.

When I was in Wyoming recently, I met with several small businessmen and women to discuss different approaches to improving economic growth in rural states like ours. The majority of these companies are already well-established and business is adequate. Just like any other ambitious business concerns, however, these companies want to expand their base and find more domestic outlets for their products. In order to do so, these companies must hire a marketing consultant and spend thousands of dollars to have a marketing feasibility study done to find just the right market for their product.

Many of these small businesses cannot afford to pay substantial fees for this advanced technical assistance. The alternative is to seek assistance from the Small Business Development Centers and the Small Business Institute at the University of Wyoming. While this counsel is beneficial to the small businesses in my state, the services of a professional consultant would be a valuable addition. However, a number of states already provide these services, and that is as it should be.

My point in all this, Mr. Chairman, is that rural America has a diverse set of needs. I believe the Small Business Administration is making a strong effort to address these needs with a number of existing and innovative pilot programs. As we continue to review possible approaches to revitalizing rural America by improving access to capital, which in turn creates jobs and fosters economic growth, I believe it is vital that we bear in mind the constraints of our budget. We have a tremendous deficit and I believe that reducing that deficit is the first and best step which we here in Congress should take to stabilize our national economy.

I share my colleagues interest in rural development. It is a difficult and challenging task and one that I do not take lightly. My hope is that we will make every effort to balance the tension between that task and our budgetary responsibilities and work to craft a rural development proposal which will not impose undue financial and administrative burdens.

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Senator BAUCUS. Thank you very much, Senator.

We are honored with the presence of Senator Boschwitz. Senator Boschwitz introduced a bill on the same subject, and we have each co-sponsored the other's bill.

Senator, welcome to the hearing. We would like to hear any statement you may have.

STATEMENT OF HON. RUDY BOSCHWITZ, A U.S. SENATOR FROM THE STATE OF MINNESOTA

Senator BOSCHWITZ. Well, Mr. Chairman, I am sorry to be late. We come in from McLean and when there is a little rain, we get tied up.

I am pleased that we are having this hearing. I think our bills are constructive bills that will expand the ability to finance small business, offer new avenues and new programs for doing that.

I believe we will find that we are going to act in coordination with the Agriculture Committee in getting this passed. I have talked to the Chairman of the Agriculture Committee. Both of us serve on that Committee. So I think that we will have considerable leverage in seeing that in a rural development package there is a good deal of small business emphasis. The small business emphasis will be broader than just rural development and will indeed pioneer small businesses wherever they are found, which is of course the object of the legislation that we introduced.

I think we ought to get on with the hearing.

[The prepared statement of Senator Boschwitz follows:]

JUNE 9, 1989

STATEMENT OF SENATOR RUDY BOSCHWITZ

SUBCOMMITTEE ON RURAL DEVELOPMENT AND FAMILY FARMING

I AM VERY PLEASED THIS MORNING, ALONG WITH SENATOR BAUCUS, TO BE ABLE TO CHAIR THIS HEARING ON A SUBJECT OF VITAL IMPORTANCE TO OUR COUNTRY'S ECONOMY. IN RECENT YEARS, MUCH ATTENTION HAS BEEN GIVEN THE PROBLEMS FACING RURAL COMMUNITIES. UNFORTUNATELY, COST-EFFECTIVE SOLUTIONS HAVE NOT BEEN EASILY ATTAINABLE. MOREOVER, PROPOSALS TO REVITALIZE RURAL ECONOMIES HAVE OFTEN BEEN AGRICULTURE-ORIENTED, IN SOME CASES OVERLOOKING THE PLIGHT OF SMALL BUSINESS.

WHILE THIS SENATOR WOULD BE THE FIRST TO RECOGNIZE THAT A PROSPEROUS AGRICULTURE IS CRITICAL TO THE ECONOMIC HEALTH OF RURAL COMMUNITIES, I WOULD FURTHER SUGGEST THAT SMALL BUSINESS IS ALSO A KEY FACTOR IN THE FORMULA FOR SUCCESS. OVER THE PAST SEVERAL DECADES, OUR COUNTRY HAS BECOME NOT ONLY A NATION OF FARMERS BUT ALSO A NATION OF SMALL BUSINESSES. TODAY, 26 PERCENT OF THE PEOPLE IN THIS COUNTRY LIVE IN NON-METROPOLITAN AREAS, BUT ONLY TWO PERCENT ARE DIRECTLY INVOLVED IN PRODUCING FOOD AND FIBER.

OUR PURPOSE THIS MORNING IS TO EXAMINE THE RELATIONSHIP BETWEEN SMALL BUSINESSES AND RURAL COMMUNITIES AND TO CONSIDER HOW SMALL BUSINESSES CAN BE BETTER EQUIPPED TO CREATE JOBS AND INVESTMENT IN RURAL AREAS. OF SPECIFIC INTEREST IS THE ISSUE OF FINANCING.

BOTH SENATOR BAUCUS AND I HAVE INTRODUCED LEGISLATION TO MAKE FINANCING FOR BUSINESS CREATION AND EXPANSION MORE ACCESSIBLE TO RURAL SMALL BUSINESSES. WE LOOK FORWARD TO RECEIVING TESTIMONY WHICH WILL FURTHER ILLUMINATE THIS ISSUE, AND PROVIDE THE BASIS FOR THE SMALL BUSINESS FINANCING TITLE OF ANY RURAL DEVELOPMENT LEGISLATION EMERGING FROM CONGRESS THIS YEAR.

BEFORE WE BEGIN, I THINK IT IS IMPORTANT TO NOTE THAT WE ARE NOT TRYING TO NATIONALIZE AN ISSUE WHICH IS CLEARLY LOCAL IN ORIGIN AND WHICH IN MY VIEW IS LOCAL IN TERMS OF SOLUTIONS. A RECENT GAO STUDY ESTIMATED THAT THERE ARE ALREADY 88 FEDERAL PROGRAMS WHICH TARGET RURAL AREAS. IT IS CLEAR THE ANSWER TO RURAL PROBLEMS IS NOT MORE FEDERAL PROGRAMS.

I BELIEVE THE SOLUTION LIES IN BETTER COORDINATION OF EXISTING PROGRAMS AMONG POLICY-MAKERS AT ALL LEVELS AND IT IS MY HOPE WE CAN BEGIN TO ACHIEVE THAT COORDINATION THROUGH THE TESTIMONY WE WILL RECEIVE THIS MORNING. I THANK THE CHAIR.

Senator BAUCUS. Thank you, Senator.

Our first witness is Mr. Edwin Holloway from the SBA.

Mr. Holloway, I see you are accompanied by two associates; is that correct?

STATEMENT OF EDWIN T. HOLLOWAY, ASSOCIATE ADMINISTRATOR FOR FINANCE AND INVESTMENT, U.S. SMALL BUSINESS ADMINISTRATION, WASHINGTON, DC, ACCOMPANIED BY JOHN R. COX, ASSOCIATE ADMINISTRATOR FOR BUSINESS DEVELOPMENT; AND WAYNE S. FOREN, DIRECTOR, OFFICE OF ECONOMIC DEVELOPMENT

Mr. HOLLOWAY. Yes, sir. I am accompanied, Mr. Chairman, by Mr. John Cox, the Associate Administrator for Business Development, as well as Mr. Wayne Foren, who is our Director of the Office of Economic Development.

Senator BAUCUS. Please proceed.

I ask that each of you summarize your statements as much as possible. Each witness' entire statement will be included in the record.

Mr. HOLLOWAY. Thank you, Mr. Chairman. Good morning to all of you on the Subcommittee here. I am Edwin Holloway, Associate Administrator for Finance and Investment of the Small Business Administration, and I have introduced my colleagues who are accompanying me here today.

I am delighted to appear before you today to discuss S. 683, the Rural Access to Capital Act of 1989, and S. 1051, the Small Business Rural Revitalization Act of 1989. Unfortunately, the Administrator of SBA, Susan Engeleiter, is unable to appear today because she is appearing with the U.S. Trade Representative, Carla Hills, at an SBA-sponsored trade conference in Niagara Falls, NY.

We share your concern about the economic stress in rural areas and the importance of small business development in rebuilding rural communities. The Small Business Administration has had a rural development initiative for the last 2 years, and rural development will continue to be a priority of the agency, as emphasized by Administrator Engeleiter at her April 11, 1989 Confirmation Hearing before the Committee.

In addition, SBA is participating in the Economic Policy Council's working group on rural development, which is considering ways to better serve rural interest through existing programs.

We understand that other bills either have been or will be introduced that will affect small business rural revitalization. The Administration's working group is also considering actions to improve the rural economy. Although the Administration is still reviewing how best to approach improving economic development in rural areas, we generally support initiatives which make better use of existing programs, that have limited budgetary impact, and that provide regulatory relief. In general, we believe that S. 1051 was written in this spirit. Our comments, however, on particular aspects of the proposed bills should be viewed as suggested improvements.

Our comments on S. 863 were provided to the Subcommittee at a hearing held at Livingston, MT as you know, Mr. Chairman, on May 24, and a copy of our statement at that hearing is attached.

Our comments and suggestions regarding S. 1051 are as follows.

On title I of S. 1051, the bill would modify the definition of a rural area as set forth in the reauthorization bill, P.L. 100-590, and permit small business investment companies to derive part of their paid-in capital from State and local government and create a new program for certified development companies. Our comments on these three provisions are as follows.

Section 101 of the bill by definition appears to establish nonmetropolitan counties as rural areas and at the same time permit certain communities in metro counties to be considered rural. We agree with this approach.

The most widely used definition of nonmetropolitan counties was developed by the Economic Research Service of the Department of Agriculture. Each county in the United States has been classified according to one of 10 codes, and those with an aggregate urban population of less than 50,000 are considered nonmetropolitan. Thus, some 2,384 of the Nation's 3,096 counties or their equivalents are classified as nonmetropolitan, representing some 23.5 percent of the Nation's 1986 estimated population.

We would suggest that the above definition of nonmetropolitan counties be substituted for the language in section 101(d)(1) of the bill and that subsection 101(d)(2) be revised to permit a political subdivision with a population of 20,000 or less which is located in a metro county and which is determined by SBA to be rural to also be included.

We believe it is critical that a clear definition for a "rural area" or community or locality be established and applied consistently for all Federal programs. The definition set forth in section 101 of the bill is different from the definition contained in S. 863, and there appears to be at least six different definitions for a rural area in the Farmers Home Administration's programs.

Section 102 of the bill would permit small business investment companies licensed pursuant to section 301(c) or 301(d) of the Small Business Investment Act that operate in a designated rural area to obtain up to $500,000 of their paid-in capital from State and local governments and not-for-profit institutions.

We have three observations concerning this section. First, the area of operation would be too restrictive. If a designated rural area means one county of 50,000 or less population or a designated rural area in a county with a larger population, we believe the area of operation should be permitted to be more than one designated rural area, but these SBICs should be clearly prohibited from operating in other than designated rural areas.

Second, this section of the bill is not clear as to whether paid-in capital derived from State and local government sources will be leveraged by the Federal Government. Section 303(b) of the SBI Act contemplates that only private paid-in capital will be leveraged.

In any event, if SBA is to leverage capital derived from State and local government, sources care should be taken to assure that such capital is not directly or indirectly derived from Federal funds.

For example, block grant funds from the Department of Housing and Urban Development may be used for this purpose. Should this occur, SBA would be providing Federal leverage financing based on Federal funds.

Third, the capital contributed by nonprofit institutions should be treated as private capital for the purposes of amended section 302(a)(2) and excluded from the restrictions set forth in this subsection unless the source of funds contributed by the not-for-profit institution originated directly or indirectly from Government sources.

We wish to emphasize that SBA does not object to the use of State and local funds as restricted to rural development purposes by the provisions of this bill, and we do not view it as precedent to be applied in other special situations.

Section 103 of the bill would establish a Rural Area Development Company Pilot Program. Under this program, qualified certified development companies would be permitted to sell a debenture of up to $1 million to capitalize a revolving loan fund provided the CDC has received a matching capital contribution from private sector sources.

This section should be clarified to state that private paid-in capital refers to private sector match for the revolving fund and not the capitalization of the certified development company.

It is noted that most CDCs do not have a significant capital base. Also, a provision needs to be added to this section to clearly state the eligible use of revolving loan funds. The purposes set forth in section 502 of the Small Business Investment Act should apply.

Since the pilot is limited to $25 million, a method of allocating funds needs to be established that will cause the most deserving proposals to be considered and funded. The concept of an economic development work plan, international competition, that was set forth in S. 863 will accomplish that objective.

Under title III on business development, this title would permit State chartered development companies such as economic development authorities that acquire property for a small business incubator located in a designated rural area to receive a grant from unobligated funds appropriated for use under the 7(j) Program. The grant would be used to buy down the interest rate up to 3 percent on financing obtained to acquire the incubator property, provided a matching grant for a similar amount was raised from private sector sources for the same purpose. It should be noted that the fiscal year 1990 budget provides no funds for the 7(j) Program.

Title IV on regulatory simplification and miscellaneous amendments would permit the waiver of a rule or regulation by any agency upon SBA's request where such rule or regulation affects job creation, community development or economic revitalization in a designated rural area. Such regulatory flexibility is always welcomed when a sound public purpose is served provided that such waivers or modifications would have the status of rules under the Administrative Procedures Act.

This title also requires SBA to conduct a review of all Federal economic development programs and all Federal laws, the purpose of which are to promote rural area business, economic and community development, or to enhance employment opportunities in rural communities.

The Administrator is to report the results of the review within 180 days after the bill is enacted and make recommendations regarding changes to existing law or proposals for additional legisla-

tion that may be required to foster and support small businesses in rural areas.

In our view, this review is a major undertaking which will require at least 1 year.

In conclusion, Mr. Chairman, rural development is an important task, and we applaud your efforts. We hope our comments and suggestions are helpful.

Mr. Chairman, this does conclude our prepared remarks, and we will be happy to answer any questions the Subcommittee may have.

[The prepared statements of Messrs. Holloway and Foren follow:]

SBA U.S Small Business Administration Washington, DC 20416

STATEMENT OF
EDWIN T. HOLLOWAY
ASSOCIATE ADMINISTRATOR FOR
FINANCE AND INVESTMENT
SMALL BUSINESS ADMINISTRATION

BEFORE THE SUBCOMMITTEE ON
RURAL ECONOMY AND FAMILY FARMING
SMALL BUSINESS COMMITTEE
UNITED STATES SENATE
JUNE 9, 1989

MR. CHAIRMAN AND MEMBERS OF THE SUBCOMMITTEE:

GOOD MORNING. I AM EDWIN T. HOLLOWAY, ASSOCIATE ADMINISTRATOR FOR FINANCE AND INVESTMENT OF THE SMALL BUSINESS ADMINISTRATION (SBA). ACCOMPANYING ME TODAY ARE JOHN COX, ASSOCIATE ADMINISTRATOR FOR BUSINESS DEVELOPMENT AND WAYNE FOREN, DIRECTOR, OFFICE OF ECONOMIC DEVELOPMENT.

I APPRECIATE THE OPPORTUNITY TO APPEAR BEFORE YOU TODAY TO DISCUSS S. 865, THE "RURAL ACCESS TO CAPITAL ACT OF 1989" AND S. 1051, THE "SMALL BUSINESS RURAL REVITALIZATION ACT OF 1989." UNFORTUNATELY, THE ADMINISTRATOR OF SBA, SUSAN ENGELEITER, IS UNABLE TO APPEAR TODAY BECAUSE SHE IS APPEARING WITH THE UNITED STATES TRADE REPRESENTATIVE, CARLA HILLS, AT A SBA SPONSORED TRADE CONFERENCE IN NIAGARA FALLS, NEW YORK.

WE SHARE YOUR CONCERN ABOUT THE ECONOMIC STRESS IN RURAL AREAS AND THE IMPORTANCE OF SMALL BUSINESS DEVELOPMENT IN REBUILDING RURAL COMMUNITIES. THE SMALL BUSINESS ADMINISTRATION (SBA) HAS HAD A RURAL DEVELOPMENT INITIATIVE FOR THE LAST TWO YEARS, AND RURAL DEVELOPMENT WILL CONTINUE TO BE A PRIORITY OF THE AGENCY, AS EMPHASIZED BY ADMINISTRATOR ENGELEITER AT HER APRIL 11, 1989, CONFIRMATION HEARING BEFORE THE COMMITTEE. IN ADDITION, THE SBA IS PARTICIPATING IN THE ECONOMIC POLICY COUNCIL'S WORKING GROUP ON RURAL DEVELOPMENT, WHICH IS CONSIDERING WAYS TO BETTER SERVE RURAL INTERESTS THROUGH EXISTING PROGRAMS.

WE UNDERSTAND THAT OTHER BILLS EITHER HAVE BEEN OR WILL BE INTRODUCED THAT WILL AFFECT SMALL BUSINESS RURAL REVITALIZATION. THE ADMINISTRATION'S WORKING GROUP IS ALSO CONSIDERING ACTIONS TO IMPROVE THE RURAL ECONOMY.

ALTHOUGH THE ADMINISTRATION IS STILL REVIEWING HOW BEST TO APPROACH IMPROVING ECONOMIC DEVELOPMENT IN RURAL AREAS, WE GENERALLY SUPPORT INITIATIVES THAT MAKE BETTER USE OF EXISTING PROGRAMS, THAT HAVE LIMITED BUDGETARY IMPACT AND THAT PROVIDE REGULATORY RELIEF. IN GENERAL, WE BELIEVE THAT S. 1051 WAS WRITTEN IN THIS SPIRIT. OUR COMMENTS, HOWEVER, ON PARTICULAR ASPECTS OF THE PROPOSED BILLS SHOULD BE VIEWED AS SUGGESTED IMPROVEMENTS.

OUR COMMENTS ON S. 863 WERE PROVIDED TO THE SUBCOMMITTEE AT A HEARING HELD IN LIVINGSTON, MONTANA ON MAY 24, 1989. A COPY OF OUR STATEMENT GIVEN AT THAT HEARING IS ATTACHED. OUR COMMENTS AND SUGGESTIONS REGARDING S. 1051 ARE AS FOLLOWS.

TITLE I - CAPITAL FORMATION

TITLE I OF THE BILL WOULD MODIFY THE DEFINITION OF A RURAL AREA AS SET FORTH IN P.L. 100-590, PERMIT SMALL BUSINESS INVESTMENT COMPANIES (SBICs) TO DERIVE PART OF THEIR PAID-IN-CAPITAL FROM STATE AND LOCAL GOVERNMENTS AND CREATE A NEW PROGRAM FOR CERTIFIED DEVELOPMENT COMPANIES (CDCs). OUR COMMENTS ON THESE THREE PROVISIONS ARE AS FOLLOWS:

SECTION 101 OF THE BILL, BY DEFINITION, APPEARS TO ESTABLISH NONMETROPOLITAN COUNTIES AS RURAL AREAS AND, AT THE SAME TIME, PERMITS CERTAIN COMMUNITIES IN METRO COUNTIES TO BE CONSIDERED RURAL. WE AGREE WITH THIS APPROACH. THE MOST WIDELY-USED DEFINITION OF NONMETROPOLITAN COUNTIES WAS DEVELOPED BY THE ECONOMIC RESEARCH SERVICE, U.S. DEPARTMENT OF AGRICULTURE. EACH COUNTY IN THE U.S. HAS BEEN CLASSIFIED ACCORDING TO ONE OF 10 CODES, AND THOSE WITH AN AGGREGATE URBAN POPULATION OF LESS THAN 50,000 ARE CONSIDERED NONMETROPOLITAN. THUS, 2,384 OF THE NATION'S 3,096 COUNTIES (OR THEIR EQUIVALENTS) ARE CLASSIFIED AS NONMETROPOLITAN, REPRESENTING 23.55% OF THE NATION'S 1986 (EST.) POPULATION.

WE WOULD SUGGEST THAT THE ABOVE DEFINITION OF NONMETROPOLITAN COUNTIES BE SUBSTITUTED FOR THE LANGUAGE IN SECTION 101(D)(1) OF THE BILL, AND THAT SUBSECTION 101(D)(2) BE REVISED TO PERMIT A POLITICAL SUBDIVISION (WITH A POPULATION OF 20,000 OR LESS), WHICH IS LOCATED IN A METRO COUNTY, AND WHICH IS DETERMINED BY SBA TO BE RURAL, TO BE INCLUDED.

WE BELIEVE IT IS CRITICAL THAT A CLEAR DEFINITION FOR A "RURAL AREA" OR "COMMUNITY" OR "LOCALITY" BE ESTABLISHED AND APPLIED CONSISTENTLY TO ALL FEDERAL PROGRAMS. THE DEFINITION SET FORTH IN SECTION 101 OF THE BILL IS DIFFERENT FROM THE DEFINITION CONTAINED IN S. 863, AND THERE APPEARS TO BE AT LEAST 6 DIFFERENT DEFINITIONS FOR A "RURAL AREA" IN THE FARMERS HOME ADMINISTRATION'S PROGRAMS.

SECTION 102 OF THE BILL WOULD PERMIT SMALL BUSINESS INVESTMENT COMPANIES LICENSED PURSUANT TO SECTIONS 301(C) OR 301(D) OF THE SMALL BUSINESS INVESTMENT ACT (SBI ACT) THAT OPERATE IN A DESIGNATED RURAL AREA TO OBTAIN UP TO $500,000 OF THEIR PAID IN CAPITAL FROM STATE AND LOCAL GOVERNMENTS AND NOT-FOR-PROFIT INSTITUTIONS.

WE HAVE THREE OBSERVATIONS CONCERNING THIS SECTION. FIRST, THE AREA OF OPERATION WOULD BE TOO RESTRICTIVE IF "A DESIGNATED RURAL AREA" MEANS ONE COUNTY OF 50,000 OR LESS POPULATION OR A DESIGNATED RURAL AREA IN A COUNTY WITH A LARGER POPULATION. WE BELIEVE THE AREA OF OPERATION SHOULD BE PERMITTED TO BE MORE THAN ONE DESIGNATED RURAL AREA BUT THESE SBICS SHOULD BE CLEARLY PROHIBITED FROM OPERATING IN OTHER THAN DESIGNATED RURAL AREAS.

SECOND, THIS SECTION OF THE BILL IS NOT CLEAR AS TO WHETHER PAID-IN-CAPITAL DERIVED FROM STATE AND LOCAL GOVERNMENT SOURCES SHALL BE LEVERAGED. SECTION 303(B) OF THE SBI ACT CONTEMPLATES THAT ONLY PRIVATE PAID-IN-CAPITAL WILL BE LEVERAGED. IN ANY EVENT, IF SBA IS TO LEVERAGE CAPITAL DERIVED FROM STATE AND LOCAL GOVERNMENT SOURCES, CARE SHOULD BE TAKEN TO ASSURE THAT SUCH CAPITAL IS NOT DIRECTLY OR INDIRECTLY DERIVED FROM FEDERAL FUNDS. FOR EXAMPLE, BLOCK GRANT FUNDS FROM THE DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT (HUD) MAY BE USED FOR THIS PURPOSE. SHOULD THIS OCCUR, SBA WOULD BE PROVIDING FEDERAL LEVERAGE FINANCING BASED ON FEDERAL FUNDS.

THIRD, THE CAPITAL CONTRIBUTED BY NON-PROFIT INSTITUTIONS SHOULD BE TREATED AS PRIVATE CAPITAL FOR THE PURPOSES OF AMENDED §302(A)(2) AND EXCLUDED FROM THE RESTRICTIONS SET FORTH IN THIS SUBSECTION UNLESS THE SOURCE OF FUNDS CONTRIBUTED BY THE NOT-FOR-PROFIT INSTITUTION ORIGINATED DIRECTLY OR INDIRECTLY FROM GOVERNMENT SOURCES.

WE WISH TO EMPHASIZE THAT SBA DOES NOT OBJECT TO THE USE OF STATE AND LOCAL FUNDS AS RESTRICTED TO RURAL DEVELOPMENT PURPOSES BY THE PROVISIONS OF THIS BILL, AND WE DO NOT VIEW IT AS A PRECEDENT TO BE APPLIED IN OTHER SPECIAL SITUATIONS.

SECTION 105 OF THE BILL WOULD ESTABLISH A RURAL AREA DEVELOPMENT COMPANY PILOT PROGRAM. UNDER THIS PROGRAM, QUALIFIED CERTIFIED DEVELOPMENT COMPANIES (CDCS) WOULD BE PERMITTED TO SELL A DEBENTURE OF UP TO $1 MILLION TO CAPITALIZE A REVOLVING LOAN FUND PROVIDED THE CDC HAS RECEIVED A MATCHING CAPITAL CONTRIBUTION FROM PRIVATE SECTOR SOURCES. THIS SECTION SHOULD BE CLARIFIED TO STATE THAT "PRIVATE-PAID-IN-CAPITAL" REFERS TO PRIVATE SECTOR MATCH FOR THE REVOLVING FUND AND NOT THE CAPITALIZATION OF THE CDC. IT IS NOTED THAT MOST CDCS DO NOT HAVE A SIGNIFICANT CAPITAL BASE. ALSO, A PROVISION NEEDS TO BE ADDED TO THIS SECTION TO CLEARLY STATE THE ELIGIBLE USE OF REVOLVING LOAN FUNDS. THE PURPOSES SET FORTH IN SECTION 502 OF THE SBI ACT SHOULD APPLY.

SINCE THE PILOT IS LIMITED TO $25 MILLION, A METHOD OF ALLOCATING FUNDS NEEDS TO BE ESTABLISHED THAT WILL CAUSE THE MOST DESERVING PROPOSALS TO BE CONSIDERED AND FUNDED. THE CONCEPT OF AN ECONOMIC DEVELOPMENT WORKPLAN AND A NATIONAL COMPETITION THAT WAS SET FORTH IN S. 863 WILL ACCOMPLISH THIS OBJECTIVE.

TITLE III - BUSINESS DEVELOPMENT

THIS TITLE WOULD PERMIT STATE CHARTERED DEVELOPMENT AGENCIES SUCH AS ECONOMIC DEVELOPMENT AUTHORITIES THAT ACQUIRE PROPERTY FOR A SMALL BUSINESS INCUBATOR LOCATED IN A DESIGNATED RURAL AREA TO RECEIVE A GRANT FROM UNOBLIGATED FUNDS APPROPRIATED FOR USE UNDER THE 7(J) PROGRAM. THE GRANT WOULD BE USED TO BUY DOWN THE INTEREST RATE BY UP TO 5 PERCENT ON FINANCING OBTAINED TO ACQUIRE THE INCUBATOR PROPERTY PROVIDED A MATCHING GRANT FOR A SIMILAR AMOUNT WAS RAISED FROM PRIVATE SECTOR SOURCES FOR THE SAME PURPOSE.

IT SHOULD BE NOTED THAT THE FY 1990 BUDGET PROVIDES NO FUNDS FOR THE 7(J) PROGRAM.

TITLE IV - REGULATORY SIMPLIFICATION; MISCELLANEOUS AMENDMENTS

THIS TITLE WOULD PERMIT THE WAIVER OF A RULE OR REGULATION BY ANY AGENCY UPON SBA'S REQUEST, WHERE SUCH RULE OR REGULATION AFFECTS JOB CREATION, COMMUNITY DEVELOPMENT, OR ECONOMIC REVITALIZATION IN A DESIGNATED RURAL AREA. SUCH REGULATORY FLEXIBILITY IS ALWAYS WELCOMED WHEN A SOUND PUBLIC PURPOSE IS SERVED, PROVIDED THAT SUCH WAIVERS OR MODIFICATIONS WOULD HAVE THE STATUS OF RULES UNDER THE ADMINISTRATIVE PROCEDURES ACT.

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THIS TITLE ALSO REQUIRES SBA TO CONDUCT A REVIEW OF ALL FEDERAL ECONOMIC DEVELOPMENT PROGRAMS AND ALL FEDERAL LAWS THE PURPOSE OF WHICH ARE TO PROMOTE RURAL AREA BUSINESS, ECONOMIC AND COMMUNITY DEVELOPMENT OR TO ENHANCE EMPLOYMENT OPPORTUNITIES IN RURAL COMMUNITIES. THE ADMINISTRATOR IS TO REPORT THE RESULTS OF THE REVIEW WITHIN 180 DAYS AFTER THE BILL IS ENACTED AND MAKE RECOMMENDATIONS REGARDING CHANGES TO EXISTING LAW OR PROPOSALS FOR ADDITIONAL LEGISLATION THAT MAY BE REQUIRED TO FOSTER AND SUPPORT SMALL BUSINESSES IN RURAL AREAS. IN OUR VIEW, THIS REVIEW IS A MAJOR UNDERTAKING WHICH WILL REQUIRE AT LEAST ONE YEAR.

CONCLUSION

IN CONCLUSION, RURAL DEVELOPMENT IS AN IMPORTANT TASK, AND WE APPLAUD YOUR EFFORTS. WE HOPE OUR COMMENTS AND SUGGESTIONS ARE HELPFUL.

MR. CHAIRMAN, THIS CONCLUDES MY PREPARED STATEMENT. I SHALL BE HAPPY TO ANSWER ANY QUESTIONS THE SUBCOMMITTEE MAY HAVE.

SBA U.S. Small Business Administration Washington, DC 20416

STATEMENT OF
WAYNE S. FOREN
DIRECTOR, OFFICE OF ECONOMIC DEVELOPMENT
SMALL BUSINESS ADMINISTRATION

BEFORE THE SUBCOMMITTEE ON
RURAL ECONOMY AND FAMILY FARMING
SMALL BUSINESS COMMITTEE
UNITED STATES SENATE
MAY 24, 1989

MR. CHAIRMAN AND MEMBERS OF THE SUBCOMMITTEE:

I APPRECIATE THE OPPORTUNITY TO APPEAR BEFORE YOU TODAY TO DISCUSS S. 759, THE "RURAL ACCESS TO TELECOMMUNICATIONS SERVICES ACT OF 1989" AND S. 863, THE "RURAL ACCESS TO CAPITAL ACT OF 1989".

WE SHARE YOUR CONCERN ABOUT THE ECONOMIC STRESS IN RURAL AREAS. THE SMALL BUSINESS ADMINISTRATION (SBA) HAS HAD A RURAL DEVELOPMENT INITIATIVE FOR THE LAST TWO YEARS, AND RURAL DEVELOPMENT WILL CONTINUE TO BE A PRIORITY OF THE AGENCY, AS EMPHASIZED BY ADMINISTRATOR ENGELEITER AT HER APRIL 11, 1989, CONFIRMATION HEARING BEFORE THE COMMITTEE. IN ADDITION, THE SBA IS PARTICIPATING IN THE ECONOMIC POLICY COUNCIL'S WORKING GROUP ON RURAL DEVELOPMENT, WHICH IS CONSIDERING WAYS TO BETTER SERVE RURAL INTERESTS THROUGH EXISTING PROGRAMS.

AS REQUESTED, I WOULD LIKE TO SHARE SOME THOUGHTS AS TO WHY PEOPLE ARE LEAVING RURAL AREAS. THEN I WOULD LIKE TO SUMMARIZE SBA'S CURRENT ACTIVITIES TO FOSTER SMALL BUSINESS DEVELOPMENT IN RURAL AREAS. FINALLY, I WOULD LIKE TO PROVIDE SOME COMMENTS AND SUGGESTIONS REGARDING SENATE BILL S. 863. SENATE BILL S. 759 CONCERNS ISSUES THAT COME UNDER THE PURVIEW OF THE U.S. DEPARTMENT OF AGRICULTURE. WE DEFER TO THE DEPARTMENT OF AGRICULTURE FOR COMMENTS ON THIS BILL.

THERE ARE NO NEW EXPLANATIONS AS TO WHY POPULATION IS LEAVING RURAL AREAS. PEOPLE LEAVE FOR BETTER JOB OPPORTUNITIES, LIFE STYLE AND CONSUMPTION POSSIBILITIES THAT URBAN AREAS PROVIDE, AND FOR OTHER REASONS. AN UNCERTAIN FUTURE FOR THE FAMILY FARM AND CHANGING TECHNOLOGY HAS CAUSED MANY TO LEAVE THE FARM OVER THE YEARS TO PURSUE OTHER OCCUPATIONS IN BUSINESS, INDUSTRY AND EDUCATION, MANY OF THESE PURSUITS HAVE BEEN IN URBAN AREAS. AS YOU KNOW, THE FACE OF RURAL AMERICA HAS CHANGED. RURAL DEVELOPMENT IS NO LONGER PREDOMINANTLY AGRICULTURE, RATHER, IT ALSO INVOLVES MINING, TIMBER, OIL, AND OTHER INDUSTRIES, SUCH AS TOURISM/RECREATION AND FISHING. THE PROPORTION OF RESIDENTS IN NONMETROPOLITAN COUNTIES FELL FROM 47.4% TO 26.5% FROM 1940 TO 1970, AND FROM 26.5% TO 23.5% FROM 1970 TO 1986.

THERE ARE MANY OPINIONS ABOUT HOW THE TREND OF PEOPLE LEAVING RURAL AREAS CAN BE REVERSED. IN SHORT, IF PEOPLE ARE GIVEN A REASON TO STAY OR TO RETURN TO RURAL COMMUNITIES, THEY WILL DO SO. THIS CAN INCLUDE QUALITY JOB OPPORTUNITIES, COMMUNITY AND OTHER RELATED SERVICES. I BELIEVE THE OUT-MIGRATION IS SLOWING, AND IN SOME RURAL STATES THERE IS A NET POPULATION INCREASE. MUCH OF THIS IS A RESULT OF ECONOMIC GROWTH OF METRO AREAS SPILLING OVER TO RURAL AREAS, SUCH AS IN NEW ENGLAND AND CALIFORNIA. SOME OF THE SLOW

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DOWN IN THE OUT-MIGRATION IS DUE TO AN AWARENESS OF THE PROBLEMS IN RURAL AMERICA AND A DESIRE ON THE PART OF THE RURAL COMMUNITIES AND THEIR LEADERS TO DO SOMETHING ABOUT THE PROBLEM. A FOCUS ON BUSINESS DEVELOPMENT, BOTH SMALL AND LARGE, IS CRITICAL TO RURAL REVITALIZATION BECAUSE IT MEANS JOBS AND AN EXPANDED TAX BASE.

THIS LEADS ME TO MY SECOND POINT, WHICH ADDRESSES THE CURRENT ACTIVITIES OF SBA IN RURAL DEVELOPMENT. AS YOU KNOW, MR. CHAIRMAN, SBA HISTORICALLY HAS PLAYED AN IMPORTANT ROLE IN ASSISTING ECONOMIC GROWTH IN RURAL AREAS. A RECENT INTERNAL STUDY OF THE AGENCY'S MAJOR FINANCIAL PROGRAMS SHOWED A FAIRLY EQUITABLE MIX OF LOAN ACTIVITY IN BOTH METROPOLITAN AND NONMETROPOLITAN COUNTIES. USING THE 1986 NONMETROPOLITAN POPULATION FIGURE (23.5%) AS A BENCHMARK, THE SBA GENERATED A SIGNIFICANT PORTION OF ITS 1988 ACTIVITIES IN THESE NONMETROPOLITAN COUNTIES. THE REGULAR BUSINESS LOAN PROGRAM (7(A) PROGRAM) GENERATED 26.5% OF ITS ACTIVITY IN NONMETROPOLITAN COUNTIES. SIMILAR FIGURES WERE NOTED WITH THE SURETY BOND GUARANTEE PROGRAM, WHICH RECORDED 22.9%, AND WITH THE DEVELOPMENT COMPANY LOAN PROGRAM, WHICH HAD 18.2% OF ITS ACTIVITY IN NONMETROPOLITAN COUNTIES.

THESE THREE PROGRAMS REPRESENT A MAJOR PORTION OF ALL FINANCIAL ACTIVITY HANDLED BY THE AGENCY. THEY REPRESENTED 84% OF THE $5.5 BILLION PROVIDED FOR SMALL BUSINESS ASSISTANCE DURING FISCAL YEAR 1988.

OVER THE PAST THREE YEARS THIS FINANCIAL COMMITMENT TO NONMETROPOLITAN AREAS HAS REMAINED RELATIVELY STABLE. THE FOLLOWING CHARTS WILL SERVE TO ILLUSTRATE:

FISCAL YEAR	NUMBER TOTAL	NUMBER NONMETRO	AMOUNT TOTAL (000)	AMOUNT NONMETRO (000)	PERCENT OF NONMETRO ACTIVITY # - %	PERCENT OF NONMETRO ACTIVITY $ - %	PERCENT NONMETRO POPULATION
*/(A) LOAN PROGRAM							
1986	14,496	4,021	$2,579,794	$682,452	27.7%	26.5%	25.5%
1987	14,767	4,471	$2,774,671	$788,788	30.3%	28.4%	25.5%
1988	15,202	4,350	$3,001,095	$795,916	28.5%	26.5%	25.5%
CERTIFIED DEVELOPMENT COMPANY LOANS							
1986	1,456	287	$ 314,110	$ 61,180	20.0%	19.5%	25.5%
1987	1,468	279	$ 337,150	$ 57,944	19.0%	17.2%	25.5%
1988	1,172	223	$ 230,150	$ 42,675	19.0%	18.2%	25.5%
SURETY BOND GUARANTEE PROGRAM							
1986	11,421	2,678	$1,256,758	$280,690	23.4%	22.7%	25.5%
1987	10,740	2,582	$1,167,604	$272,309	24.0%	23.3%	25.5%
1988	11,048	2,591	$1,289,564	$295,780	23.4%	22.9%	25.5%

* DIRECT AND GUARANTEED LOANS, IN OUR GENERAL BUSINESS AND VETERAN CATEGORIES, ONLY.—

IN 1988, SBA STARTED AN AGGRESSIVE RURAL DEVELOPMENT OUTREACH EFFORT. THE PRIMARY FOCUS OF THIS PROGRAM WAS THE DEVELOPMENT OF AN ACTION AGENDA BASED ON THE RECOMMENDATIONS OF REPRESENTATIVES FROM RURAL AREAS. DURING 1989 WE HAVE BEGUN TRANSLATING THOSE NEEDS INTO SPECIFIC PROJECTS DESIGNED TO MOVE INFORMATION, SUPPORT RESOURCES AND EDUCATIONAL ASSISTANCE DIRECTLY INTO RURAL AREAS.

THE FIRST OF THESE EFFORTS IS CURRENTLY UNDERWAY IN TENNESSEE, WITH THE DEPLOYMENT OF A NEW MOBILE SMALL BUSINESS ASSISTANCE CENTER. THIS MOBILE CENTER IS DESIGNED TO PLACE BUSINESS SUPPORT SERVICES DIRECTLY IN THE HANDS OF SMALL TOWN BUSINESS PEOPLE. AS PART OF A JOINT EFFORT, INVOLVING THE SMALL BUSINESS ADMINISTRATION AND THE TENNESSEE VALLEY AUTHORITY, THE MOBILE SMALL BUSINESS ASSISTANCE CENTER IS DESIGNED TO ASSIST NONMETRO AREAS IN JOB EXPANSION OPPORTUNITIES THROUGH THE DELIVERY OF TECHNICAL AND FINANCIAL ASSISTANCE PROGRAMS TO REMOTE AREAS.

WE FIRMLY BELIEVE THIS TYPE OF EFFORT WILL BEAR FRUIT. IT WILL PROVIDE RURAL BUSINESS PEOPLE AND POTENTIAL ENTREPRENEURS THE FULL RANGE OF SERVICES THEY SO DESPERATELY NEED. PERHAPS EVEN MORE IMPORTANT IS THE COOPERATIVE EFFORT BEING ESTABLISHED AMONG LOCAL, STATE AND FEDERAL AGENCIES. WE FIRMLY BELIEVE THESE JOINT PARTNERSHIPS WILL HELP SMALL BUSINESS GROWTH IN RURAL AREAS.

I WOULD NOW LIKE TO TAKE A FEW MOMENTS TO MAKE SOME SPECIFIC COMMENTS REGARDING S. 665, WHICH IS UNDER DISCUSSION TODAY.

S. 665, "RURAL ACCESS TO CAPITAL ACT OF 1989"

WE SHARE MANY OF YOUR CONCERNS AS EXPRESSED IN THE FINDINGS SET FORTH IN SECTION 1 OF THE S. 665, AND WE AGREE WITH THE PURPOSE THAT FINANCIAL INSTITUTIONS AND OTHER ORGANIZATIONS SHOULD BE ENCOURAGED TO INVEST IN RURAL BUSINESSES AND TO CREATE JOBS IN RURAL COMMUNITIES. WE ALSO AGREE THAT TECHNICAL ASSISTANCE IS NEEDED IN MANY, BUT NOT ALL, CASES. IT SHOULD BE NOTED THAT RURAL AMERICA HAS A DIVERSE SET OF ECONOMIES, RESOURCES, AND NEEDS.

WE UNDERSTAND THAT OTHER BILLS EITHER HAVE BEEN OR WILL BE INTRODUCED THAT WILL AFFECT RURAL ACCESS TO CAPITAL. THE ADMINISTRATION'S WORKING GROUP IS ALSO CONSIDERING ACTIONS TO IMPROVE THE RURAL ECONOMY. AS EACH OPTION IS EVALUATED, WE WOULD HOPE THAT A COMPREHENSIVE RURAL ACCESS TO CAPITAL BILL WOULD EMERGE THAT ACHIEVES YOUR PURPOSES IN AN EFFICIENT, EFFECTIVE AND ECONOMICAL MANNER AND, AT THE SAME TIME, BE CONSISTENT WITH THE PROVISIONS OF P.L. 100-590 AND OTHER LEGISLATION THAT IMPACTS IMPROVED ACCESS TO CAPITAL FOR RURAL SMALL BUSINESSES.

AS WE REVIEW POSSIBLE APPROACHES TO IMPROVING ACCESS TO CAPITAL, AND THEREBY CREATING JOBS, IN RURAL AMERICA, WE MUST EVALUATE BOTH THE COSTS AND BENEFITS OF VARIOUS APPROACHES. BOTH THE ADMINISTRATION AND CONGRESS CURRENTLY ARE FACING ENORMOUS CHALLENGES IN BALANCING COMPETING PRIORITIES FOR ALREADY EXISTING, DISCRETIONARY DOMESTIC SPENDING PROGRAMS. THIS MAKES THE BURDEN OF PROOF ALL THE MORE STRINGENT FOR CREATING NEW PROGRAMS AND INITIATIVES.

THE DIRECT LENDING AND GRANT PROGRAMS PROPOSED IN BILLS SUCH AS S. 863 CONTRIBUTE DIRECTLY TO FEDERAL OUTLAYS. IN ADDITION, THE ADMINISTRATIVE BURDEN OF THE PROGRAMS SET FORTH IN TITLES I AND II ON SBA AND THE TREASURY IS MUCH GREATER THAN IS WARRANTED BY THE LIMITED RESOURCES ASSOCIATED WITH THESE PROGRAMS. THERE WILL BE THREE SEPARATE FUNDS ESTABLISHED AT THE TREASURY DEPARTMENT TO ACCOUNT FOR A TOTAL OF $50 MILLION. TWO OF THESE FUNDS WILL BE REVOLVING FUNDS. SBA WILL RECEIVE HUNDREDS OF WORK PLANS FROM A VARIETY OF TYPES OF APPLICANTS, MANY OF WHOM WILL BE UNQUALIFIED TO ADMINISTER A REVOLVING LOAN FUND. SINCE THERE WILL BE A NATIONAL COMPETITION, APPLICATIONS WILL BE RECEIVED AT THE LOCAL LEVEL, AND THE FINAL DECISIONS WILL BE MADE BY THE CENTRAL OFFICE OF SBA. FINALLY, EACH SUCCESSFUL APPLICANT MUST BE MONITORED BY SBA TO ASSURE THAT FUNDS HAVE BEEN PROPERLY USED.

WE BELIEVE THAT THE SBA'S CURRENT CERTIFIED DEVELOPMENT COMPANY PROGRAM, ITS 7(A) LOAN PROGRAM, AND OTHER PROGRAMS ADMINISTERED BY THE DEPARTMENTS OF AGRICULTURE, HOUSING AND URBAN DEVELOPMENT, AND COMMERCE (ECONOMIC DEVELOPMENT ADMINISTRATION) PROVIDE MANY OF THE PROGRAM BENEFITS INTENDED BY S. 863, WITHOUT ESTABLISHING COSTLY NEW SPENDING PROGRAMS WITH SUBSTANTIAL ADMINISTRATIVE COSTS.

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ALTHOUGH THE ADMINISTRATION HAS NOT YET FINALIZED A POSITION ON HOW BEST TO APPROACH IMPROVING ECONOMIC DEVELOPMENT IN RURAL AREAS, WE ARE GENERALLY OPPOSED TO NEW SPENDING PROGRAMS, SUCH AS THOSE PROPOSED IN S. 865. HOWEVER, THE ADMINISTRATION'S ENTERPRISE ZONE PROPOSAL IS A BETTER APPROACH BECAUSE IT INCLUDES LABOR AND CAPITAL-BASED TAX INCENTIVES AND REGULATORY RELIEF. OUR COMMENTS BELOW ON PARTICULAR ASPECTS OF THE PROPOSED BILL SHOULD BE VIEWED AS WAYS TO IMPROVE SUCH PROGRAMS, IF THEY WERE ENACTED, AND NOT NECESSARILY AS ENDORSEMENTS OF THE BILL'S PROVISIONS.

DEFINITION OF RURAL COMMUNITY

SECTION 101(4) OF THE BILL, BY DEFINITION, APPEARS TO ESTABLISH NONMETROPOLITAN COUNTIES AS RURAL AREAS AND, AT THE SAME TIME, PERMITS CERTAIN COMMUNITIES IN METRO COUNTIES TO BE CONSIDERED RURAL. WE AGREE WITH THIS APPROACH. THE MOST WIDELY-USED DEFINITION AND IDENTIFICATION OF NONMETROPOLITAN COUNTIES ARE THOSE THAT HAVE BEEN DEVELOPED BY THE ECONOMIC RESEARCH SERVICE, U.S. DEPARTMENT OF AGRICULTURE. EACH COUNTY IN THE U.S. HAS BEEN CLASSIFIED ACCORDING TO ONE OF 10 CODES, AND THOSE WITH AN AGGREGATE URBAN POPULATION OF LESS THAN 50,000 ARE CONSIDERED NONMETROPOLITAN. THUS, 2,534 OF THE NATION'S 3,036 COUNTIES (OR THEIR EQUIVALENTS) ARE CLASSIFIED AS NONMETROPOLITAN, REPRESENTING 23.55% OF THE NATION'S 1986 (EST.) POPULATION.

WE WOULD SUGGEST THAT SUCH NONMETROPOLITAN COUNTIES BE SUBSTITUTED FOR THE LANGUAGE IN SECTION 101(4)(A) OF THE BILL, AND THAT SUBSECTION 101(4)(B) BE REVISED TO PERMIT A POLITICAL SUBDIVISION (WITH A POPULATION OF 20,000 OR LESS), WHICH IS LOCATED IN A METRO COUNTY, AND WHICH IS DETERMINED BY SBA TO BE RURAL, TO BE INCLUDED.

WE BELIEVE IT IS CRITICAL THAT A CLEAR DEFINITION FOR A "RURAL AREA" OR "COMMUNITY" OR "LOCALITY" BE ESTABLISHED AND APPLIED CONSISTENTLY TO ALL FEDERAL PROGRAMS. THE DEFINITION SET FORTH IN SECTION 101(4) OF THE BILL IS DIFFERENT FROM THE DEFINITION PROVIDED IN SECTION 115(8) OF P.L. 100-590, ENACTED LAST NOVEMBER 5. WE ALSO NOTE THAT A THIRD DEFINITION IS SET FORTH IN S. 851, WHICH WAS INTRODUCED BY SENATOR BOSCHWITZ, AND THAT THERE APPEAR TO BE AT LEAST 3 DIFFERENT DEFINITIONS FOR A "RURAL AREA" IN THE FARMERS HOME ADMINISTRATION'S PROGRAMS.

TITLE I - PUBLIC AND PRIVATE RURAL PARTNERSHIP FUND

THIS TITLE CONTEMPLATES THAT VARIOUS PUBLIC AND NON-PROFIT PRIVATE ENTITIES SERVING RURAL COMMUNITIES (APPLICANTS) WOULD SUBMIT AN ECONOMIC DEVELOPMENT WORK PLAN TO SBA AND A LOAN REQUEST TO BORROW FUNDS TO CAPITALIZE THEIR REVOLVING LOAN AND INVESTMENT FUND. THE WORK PLAN WOULD DESCRIBE THE BUSINESSES WHICH THE APPLICANT PLANS TO ASSIST, THE TYPE OF ASSISTANCE TO BE PROVIDED (LOAN GUARANTEES, LOANS, EQUITY CAPITAL OR TECHNICAL ASSISTANCE), AND AN ESTIMATE OF JOBS TO BE CREATED OR RETAINED. SBA WOULD THEN AWARD LOANS TO APPLICANTS, BASED UPON A NATIONWIDE COMPETITION. SINCE THE AUTHORIZED LEVEL FOR THIS FUND WOULD BE $50 MILLION, AND THE MAXIMUM AMOUNT TO ANY APPLICANT IS $1 MILLION, WE WOULD EXPECT THERE TO BE BETWEEN 30 AND 50 SUCCESSFUL APPLICANTS.

ELIGIBLE APPLICANTS - WE STRONGLY RECOMMEND THAT ELIGIBLE APPLICANTS BE RESTRICTED TO DEVELOPMENT COMPANIES CERTIFIED BY SBA PURSUANT TO TITLE V OF THE SMALL BUSINESS INVESTMENT ACT OF 1958, AS AMENDED. THESE CERTIFIED DEVELOPMENT COMPANIES (CDCS) ARE ORGANIZATIONS THAT ARE REGULATED BY SBA. MOST CDCS ARE NON-PROFIT ORGANIZATIONS THAT PROVIDE FINANCIAL ASSISTANCE TO

SMALL BUSINESS CONCERNS AS A MEANS OF FOSTERING COMMUNITY ECONOMIC DEVELOPMENT. THEY PROVIDE FIXED ASSET FINANCING UNDER SBA'S SECTION 502 AND 504 LOAN PROGRAMS. IN ADDITION, MANY PACKAGE LOANS WHICH ARE MADE BY BANKS AND NON-BANK LENDERS AND ARE GUARANTEED BY SBA UNDER THE SECTION 7(A) BUSINESS LOAN PROGRAM, AND OTHERS ADMINISTER REVOLVING LOAN FUNDS THAT WERE CAPITALIZED WITH GRANTS FROM THE ECONOMIC DEVELOPMENT ADMINISTRATION AND OTHER SOURCES.

THE MEMBERSHIP OF A CDC IS COMPOSED OF FINANCIAL INSTITUTIONS, LOCAL GOVERNMENT, COMMUNITY ORGANIZATIONS AND BUSINESS ORGANIZATIONS (SUCH AS CHAMBERS OF COMMERCE, ELECTRIC OR TELEPHONE COOPERATIVES, AND OTHER UTILITIES, ETC.). OF THE 430 CDCS THAT ARE PRESENTLY CERTIFIED, 95 ARE ECONOMIC DEVELOPMENT DISTRICTS OR REGIONAL PLANNING COMMISSIONS THAT SERVE RURAL AMERICA. FREQUENTLY, THE ELIGIBLE APPLICANTS IDENTIFIED IN THE BILL ARE TYPICAL MEMBERS OF CDCS.

IT IS IMPORTANT THAT THE SUCCESSFUL APPLICANTS DEMONSTRATE THE CAPABILITY TO MAKE, CLOSE AND SERVICE TERM COMMERCIAL LOANS, SINCE THEY WOULD BE ADMINISTERING A REVOLVING LOAN FUND.

ELIGIBLE USE OF PROCEEDS - WE BELIEVE ELIGIBLE USE OF PROCEEDS SHOULD BE LIMITED TO LOANS TO SMALL BUSINESS CONCERNS, AND EQUITY INVESTMENTS AND TECHNICAL ASSISTANCE SHOULD NOT BE PERMITTED. IF THE FUNDS ARE MADE AVAILABLE TO THE APPLICANT BY SBA ON A LOAN BASIS, THESE FUNDS SHOULD BE RELOANED TO BORROWERS. OTHERWISE, THERE WILL NOT BE SUFFICIENT RESOURCES IN THE APPLICANT'S REVOLVING FUND TO MAKE LOAN REPAYMENT TO THE RURAL PARTNERSHIP FUND.

TITLE II - MICROBUSINESS LOAN AND TECHNICAL ASSISTANCE FUND ("M L & T A FUND)

THIS IS A PROGRAM TO MAKE FINANCIAL AND TECHNICAL ASSISTANCE AVAILABLE TO BUSINESSES WITH NO MORE THAN 15 FULL-TIME (OR EQUIVALENT) EMPLOYEES, AND THE MAXIMUM LOAN WOULD BE $25,000. A LIMITED AMOUNT OF TECHNICAL ASSISTANCE WOULD ALSO BE AVAILABLE. IT IS CONTEMPLATED THAT VARIOUS PUBLIC AND NON-PROFIT PRIVATE ENTITIES SERVING A RURAL COMMUNITY (APPLICANTS) WOULD SUBMIT A COMBINATION GRANT AND LOAN REQUEST. THE REQUEST WOULD BE PURSUANT TO AN ECONOMIC DEVELOPMENT WORK PLAN, AND SBA WOULD THEN AWARD GRANTS AND LOANS TO APPLICANTS, BASED UPON A NATIONWIDE COMPETITION. SINCE THE BILL REQUIRES THAT SBA SELECT A TOTAL OF 50 ELIGIBLE APPLICANTS FOR THESE LOANS AND GRANTS, THE MAXIMUM AMOUNT WILL BE PROVIDED TO EACH APPLICANT. THEREFORE, THE GRANT WILL BE $100,000 FOR TECHNICAL ASSISTANCE, AND THE LOAN WILL BE FOR $300,000 TO CAPITALIZE A REVOLVING LOAN FUND. IN SHORT, EACH OF THE 50 SUCCESSFUL APPLICANTS WILL RECEIVE A TOTAL OF $400,000 FOR THEIR M L & T A FUND.

WE BELIEVE ELIGIBLE APPLICANTS FOR THE MICROBUSINESS LOAN AND TECHNICAL ASSISTANCE FUND SHOULD, ALSO, BE LIMITED TO CDCS BECAUSE OF THEIR PUBLIC PURPOSE AND THE FACT THAT THEY ARE REGULATED BY SBA. ALSO, THE $25,000 MAXIMUM LOAN LEVEL TO ANY MICROBUSINESS IS SIMPLY TOO LOW TO HAVE ANY APPRECIABLE OR SIGNIFICANT VALUE.

TITLE III - TRANSFER OF SMALL BUSINESS LENDING COMPANY STATUS

THIS PROVISION WOULD REQUIRE SBA TO APPROVE THE TRANSFER OF A SMALL BUSINESS LENDING COMPANY (SBLC) STATUS FROM AN ENTITY CERTIFIED BY SBA TO ANOTHER ENTITY MEETING THE ELIGIBILITY REQUIREMENTS SET FORTH IN SECTION 120.302-1 OF SBA REGULATIONS. WE STRONGLY OPPOSE THIS PROVISION, IF IT MEANS WE ARE

REQUIRED TO APPROVE A TRANSFER OF AN SBLC CERTIFICATE FROM ONE ENTITY TO ANOTHER, OR IF WE ARE REQUIRED TO APPROVE THE TRANSFER OF OWNERSHIP AND CONTROL OF AN ENTITY THAT IS AN SBLC BUT WHICH IS NOT IN GOOD STANDING WITH THE REQUIREMENTS OF THE ABOVE-CITED REGULATIONS.

THERE ARE 6 SBLCS THAT ARE NOT IN GOOD STANDING WITH SECTION 120.302-1 OF SBA REGULATIONS, AND ACTION IS BEING TAKEN TO REVOKE THE CERTIFICATES OF THESE ENTITIES.

ON JANUARY 4, 1982 SBA TERMINATED THE ELIGIBLITY PROVISION THAT WOULD PERMIT ADDITIONAL NON-BANK LENDERS, REGULATED SOLELY BY SBA (SBLCS), TO BE PARTICIPATING LENDERS UNDER THE 7(A) PROGRAM. IT IS OUR VIEW THAT SBA LACKS THE RESOURCES NECESSARY TO ADEQUATELY MONITOR ADDITIONAL LENDERS WHICH ARE NOT SUBJECT TO THE REGULATION AND SUPERVISION OF A FEDERAL OR STATE AUTHORITY, SUCH AS THE OFFICE OF THE COMPTROLLER OF THE CURRENCY OR A STATE BANKING DEPARTMENT.

CONCLUSION

IN CONCLUSION, RURAL DEVELOPMENT IS AN IMPORTANT TASK, AND WE APPLAUD YOUR EFFORTS. UNTIL THE ECONOMIC POLICY COUNCIL'S WORKING GROUP HAS HAD AN OPPORTUNITY TO CAREFULLY CONSIDER THIS, AND OTHER BILLS THAT AFFECT ACCESS TO CAPITAL IN RURAL AREAS, IT WOULD BE PREMATURE TO EITHER SUPPORT OR OPPOSE THIS BILL. HOWEVER, WE HOPE OUR COMMENTS AND SUGGESTIONS ARE HELPFUL.

MR. CHAIRMAN, THIS CONCLUDES MY PREPARED STATEMENT. I SHALL BE HAPPY TO ANSWER ANY QUESTIONS THE SUBCOMMITTEE MAY HAVE.

U.S. SMALL BUSINESS ADMINISTRATION
WASHINGTON, D.C. 20416

JUN 20 1989

Honorable Rudy Boschwitz
United States Senate
Washington, D.C. 20510

Dear Senator Boschwitz:

Thank you for your letter of June 14, 1989 with reference to the Small Business Committee's Subcommittee on Rural Economy and Family Farming hearing of June 9, 1989, enclosing questions from Senator Grassley to be answered for the hearing record.

I enclose herewith my responses to the questions.

Sincerely,

Edwin T. Holloway
Associate Administrator
for Finance and Investment

Enclosure

QUESTIONS SUBMITTED BY SENATOR GRASSLEY
JUNE 9, 1989 HEARING RECORD

QUESTIONS FOR EDWIN HOLLOWAY:

Question:

While revolving loan funds have been successful, they are usually limited by the amount of capital available in them. There is some discussion that a secondary mortgage market, in which any qualified lender could participate, would open up capital to virtually every corner of rural America. Would a secondary market approach to rural development be workable?

Answer:

We believe a secondary market approach to rural development would be workable. A readily available secondary market would encourage existing lenders to make loans with the knowledge that they could be quickly and profitably turned into relendable cash, leaving the lender with a stream of continuing income from loan servicing.

Question:

As you are probably aware, a new secondary market for farm loans will be up and running sometime this fall. Would Farmer Mac be the most appropriate of the secondary markets - since its mission is already directed to rural purposes?

Answer:

Farmer Mac could be one of two appropriate secondary markets. It could handle the agricultural loans for which it was designed. The second appropriate market would be the existing SBA system to handle rural business loans. It is already accommodating approximately 50% of present SBA loan volume.

Question:

What are the necessary changes or inclusions that should be considered before a secondary market would be used as a vehicle for financing rural development?

Answer:

We know of no legislative changes that would be required to make such an approach workable. We believe it is workable now.

Senator BAUCUS. Thank you very much, Mr. Holloway.

I understand that SBA is concerned that my bill imposes administrative complexities too great to warrant full SBA support. The SBA suggests that the program should be conducted through certified development companies instead of local nonprofit organizations.

The major problem I have with SBA's suggestion is that Montana, for example, doesn't have an active CDC. It does, however, have very active nonprofit entities that work hard at developing local economies. Why shouldn't these entities be able to participate more fully in developing their local rural communities by processing business loans?

Mr. HOLLOWAY. Mr. Chairman, I think the answer to that is a question of priorities. I believe that our challenge in the Federal establishment to do more with less, to make high productivity use of our resources demands that we prioritize and put our resources where we can get the most bang for the buck.

I believe that with our existing CDCs which already have a relationship with the Small Business Administration, are out there, are regulated by us, in the context of today's budgetary environment we can do more with less there and meet the challenge.

Senator BAUCUS. I understand the general principle. But Montana does not have an operating CDC. Ours is virtually defunct.

Mr. HOLLOWAY. I understand your point, Mr. Chairman.

Senator BAUCUS. Well, we have to find another solution then.

I think it makes sense for us to enable local nonprofits to provide capital for economic development in rural areas?

Mr. HOLLOWAY. I believe the solution is going to revolve around the fact that in this country the primary vehicle to deliver financial assistance out there is going to be the private sector financial institutions and that we as Government can find ways to give a helping hand and to help and to be a catalyst in that type of thing. But I believe somehow if we can through education and the efforts of the political power structure get the private sector financial community more interested in rural area financial assistance, it will be a great help to us.

Senator BAUCUS. I appreciate that, but as you know, under my bill a nonprofit must have secured a commitment from a local private financial institution on a 50/50 basis before the nonprofit would receive any funds.

Mr. HOLLOWAY. Mr. Foren makes to me the point that certainly we recognize that we need to work together to get the CDCs organized and in rural States like Montana.

Senator BAUCUS. I agree. We have to fix it or find something else. In my judgment, trying to fix up CDCs in our State is not in and of itself sufficient because of the nature of the State. Montana is huge. I doubt if a few CDC's here and there will be able to sufficiently address the problem.

Thank you very much.

Mr. Boschwitz.

Senator BOSCHWITZ. Well, I thank you, Mr. Holloway. Your suggestions with respect to the bills that we have introduced are, I think, very useful. You have made a careful analysis of our bill, and I thank you for your suggestions with respect to redefining

some of the definitions and broadening some of those definitions. We are going to take that seriously.

The idea that the rural area community is defined at least six different ways in the Farmers Home Administration programs and the fact that now we are going to add yet another one. You never know. We really ought to be acting under one set of rules, so to speak.

So perhaps the different objective leads to different definitions. Do you feel that there is one definition that could be used that would encompass programs as you know them at SBA?

Mr. HOLLOWAY. Yes. We endorse the definition by the Department of Agriculture at the Economic Research Service.

Senator BOSCHWITZ. I see.

Also, your observation that we are too restrictive in defining a designated rural area is one that we will take seriously.

I did not quite understand your third comment, but perhaps the staff understands that better.

The capital contributed by nonprofit institutions should be treated as private capital for the purpose of amended 302(a)(2) and excluded from restrictions. Could you just put that into less bureaucratic terminology?

Mr. HOLLOWAY. I would be glad to, Senator. The idea is in the venture capital or SBIC Program that you harness up the private sector money and the private sector management ability and that you utilize that to make the judgment necessary to do the venture and equity capital lending and that in furtherance of that we provide certain leverage or additional funding through Government sources.

We have very steadfastly defended the idea that if we, instead of getting private capital, have Government capital and then Government guarantees and Government leverage and funding on top of the Government source of funds that we leave out the central ingredient; that is, the private sector funding and the private sector management ability to carry out these programs, which is perhaps even more important than the money and the private sector ability to make these judgments.

So what we are really saying there is that in general we do not mind leveraging private funds, but where something is directly or indirectly a Government fund and all of a sudden it is just Government leveraging Government that we have to take a little more careful look at it.

Senator BOSCHWITZ. That point was made in other parts of your testimony, and I think that point is well made. I think that your testimony as a whole is very constructive. It is thoughtful and constructive, and we thank you for it. We will review carefully our own legislation and make some changes.

There are some changes that I think we could make on the basis of your testimony, and so we thank you very much for giving us that.

Senator BAUCUS. Thank you very much, Senator.

Senator Burns.

Senator BURNS. I have no questions, Mr. Chairman.

Senator BAUCUS. Thank you gentlemen very much. We appreciate fearing your views.

Our next two witnesses are Mr. Arlen Kangas, who is president of the Midwest Minnesota Community Development Corporation in Detroit Lakes, MN; and Mr. Jeff Doose, president of Southern Ventures in Arkadelphia, AR.

Senator BOSCHWITZ. I might say Mr. Kangas is from Detroit Lakes and is well known to be an aggressive and competent developer.

One of the more distinguished residents of Detroit Lakes, MN, is Senator Burdick of North Dakota. As a matter of fact, most of North Dakota comes over to Detroit Lakes, MN in the summertime, and Senator Burdick is one of our good friends up there.

Senator BAUCUS. Thank you.

Mr. Kangas.

Senator BOSCHWITZ. We hope he does not want to run from our State, however. [Laughter.]

Senator BAUCUS. Mr. Kangas, please proceed.

STATEMENT OF ARLEN KANGAS, PRESIDENT, MIDWEST MINNESOTA COMMUNITY DEVELOPMENT CORPORATION, DETROIT LAKES, MN

Mr. KANGAS. Chairman Baucus, distinguished Members of the Subcommittee, I am honored to offer this testimony concerning development in rural areas. My name is Arlen Kangas, and I am the president of the Midwest Minnesota Community Development Corporation, MMCDC as we know it, is better known as a nonprofit corporation whose business is the financing of rural businesses. While we are headquartered in Minnesota, we also operate in Kansas, Nebraska, and South Dakota. In fact, we are licensed to do business in all 50 States.

We utilize both private and public capital to finance expanding operations in rural areas with an emphasis on promoting rural development and the promotion of agricultural-related products.

As Members of this Subcommittee are aware, rural areas have not been blessed with economic recovery that other urban areas have, and while this fact is recognized in my hometown of Detroit Lakes to Washington, DC, there is less recognition as to the cause of this disparative growth.

Problems of rural areas today are not unlike the problems rural areas faced 100 years ago. Rural areas again face a changing economy whereby market forces, vast improvements in technology, and changes in demographics, dictate new and harsh economic realities.

Competitive worldwide markets have dictated changes in farming practices and, as in any competitive business, profits are squeezed. Debt-laden and drought-stricken farmers are unlikely to have the financial reserves to withstand losses, and farmers suffer.

Improving technology minimizes the need for agricultural labor. As rural residents migrate to larger cities, demand for goods and services fall, and Main Street businesses suffer.

Changing demographics have caused local schools and hospitals to merge or even close, and rural residents suffer.

While we can attempt to reverse the course of events, it may be done only at great costs. These are fundamental structural changes in our economy, but rather than attempt to reverse this course,

perhaps we instead can recognize the problem and pursue a more logical course of action.

I contend that change is irreversible. Our mission must be to help those dislocated by economic change. Let us help those dislocated to take advantage of new opportunities.

The Senate Small Business Committee can and should take new action to stimulate rural business, thereby creating new opportunities for rural residents.

Rural businesses face three basic problems: Lack of management experience or talent; the inability to market their products effectively; and/or finally, lack of capital to establish on expand their business.

The two bills that I have been asked to comment upon, S. 863 and S. 1051, each address the three main problems I mentioned above.

The Rural Access to Capital Act of 1989 provides both capital and assistance in management and marketing. The Small Business Rural Revitalization Act also meets the criteria that I have set forth; however, I believe there is a better approach already in place to accomplish the goals that each bill is attempting to achieve.

The Nonprofit National Corporations Loan and Grant Program administered by the Farmers Home Administration effectively meets these three major needs of rural businesses. This program calls for private lenders to provide the majority of capital with the Farmers Home guarantee.

Farmers Home also provides grant funds to augment private capital. These grants are used to provide a revolving loan fund and also for provision of technical assistance. The Small Business Administration could fashion a similar program. Highlights of the program include: lower cost to the Federal Government since guarantees are used on loan funds from private lenders to nonprofit corporations.

Private lenders become the regulatory body rather than an agency in Washington.

Nonprofit corporations effectively administer the fund with proceeds from interest earned, thereby providing an incentive to make prudent loans.

Fourth, funds are provided to acquire technical assistance from private sector consultants, the most effective advice available. Small loans can be offered since the program is enhanced by public sector dollars.

Lastly, a high standard of ability must be obtained by the nonprofit corporation since private lenders make loans to businesses through the nonprofit and the nonprofit guarantees repayment to the private lender.

This approach is very novel but very effective. It provides for the proper incentives for lenders for the nonprofit and for rural businesses. It appropriately spreads the risk to businesses, nonprofits, private lenders, and the Federal Government.

While there are problems with the program I just described, there too are problems with the legislation now being considered. The SBA 504 Debenture programs are most effectively used in large cities with larger projects, since transaction costs are higher.

The Rural Partnership Fund seeks private participation but could provide an incentive for lenders to utilize public funds to shore up bad loans.

In summary, rural economies are changing. We cannot stop change even if we so desire. We can, however, effectively manage this change to the advantage of rural areas. New programs coming from Washington need to address the three main problems faced by rural business: Management; marketing; and finance. The most effective approach is through loans and grants made to capable nonprofits where the risks are shared between the businesses, private lenders, nonprofit corporations, and the Federal Government.

I would like to thank the Subcommittee for inviting me to offer this testimony and wish you well in your important deliberations. I would be happy to answer any questions you may have.

[The prepared statement of Mr. Kangas follows:]

21-344 0 - 89 - 4

Statement of the

Midwest Minnesota Community Development Corporation

Submitted for the Record to the

Senate Small Business Committee

I) Introduction

Chairman Baucus, distinguished members of the Committee, I am honored to offer this testimony concerning development of rural areas. My name is Arlen Kangas and I am the President of the Midwest Minnesota Community Development Corporation (MMCDC).

MMCDC is a nonprofit corporation whose business is the financing of rural businesses. While we are headquartered in Minnesota we also operate in Kansas, Nebraska and South Dakota. We utilize both private and public capital to finance expanding operations in rural areas with an emphasis on promoting development of agriculturally related products.

As members of this committee are aware, rural areas have not been blessed with the economic recovery in this decade that urban areas have enjoyed. While this fact is recognized from my home town of Detroit Lakes, Minnesota to Washington, D.C. there is less recognition as to the cause of this disparate growth.

II) Statement of the Problem

The problems rural area face today are not unlike the problems rural areas faced one hundred years ago. Rural areas again face a changing economy whereby market forces, vast improvements in technology and changing demographics dictate new and harsh economic realities.

Competitive, world-wide markets have dictated changes in farming practices. As in any competitive business profits are squeezed. Debt laden and drought stricken farmers are unlikely to have the financial reserves to withstand losses; and farmers suffer.

Improving technology minimizes the need for agricultural labor. As rural resident migrate to larger cities demand for goods and services fall; and mainstreet businesses suffer. Changing demographics have caused local schools and hospitals to merge or even close; and rural residents suffer.

While we can attempt to reverse the course of events, it may be done only at great cost. These are fundamental structural changes in our economy but rather than reverse this course, perhaps instead we can recognize the problem and pursue a more logical course of action.

I contend that change is irreversible. Our mission must be to help those dislocated by economic change. Let us help those dislocated to take advantage of new opportunities.

III) Proposed Actions

The Senate Small Business Committee can and should take new action to stimulate rural business thereby creating new opportunities for rural residents. Rural businesses face three problems:

1) Lack of management experience or talent,

2) Inability to market their product effectively, and/or,

3) Lack of risk capital to establish or expand their business

The two bills that I have been asked to comment upon, S.863 and S.1051, each address the three main problems faced by rural business.

The Rural Access to Capital Act of 1989 provides both capital and assistance in management and marketing. The Small Business Rural Revitalization Act also meets the criteria that I have set forth.

IV) The Nonprofit National Corporations Loan and Grant Program

However, I believe there is a better approach already in place to accomplish the goals that each bill is attempting to achieve. The Nonprofit National Corporations Loan and Grant Program effectively meets the three major needs of rural businesses. This Farmers Home Administration program calls for private lenders to provide the majority of credit with an FmHA guarantee. FmHA provides grant funds to augment private capital. These grant funds are used to provide a revolving loan fund and also for provision of technical assistance. The Small Business Administration could fashion a similar program.

Highlights of the Program Include:

1) Lower cost to the Federal Government since guarantees are used on loan funds from private lenders to nonprofit corporations.

2) Private lenders become the regulatory body, rather than an agency in Washington.

3) Nonprofit Corporations effectively administer the fund with proceeds from interest earned thereby providing an incentive to make prudent loans.

4) Funds are provided to acquire technical assistance from private sector consultants, the most effective advise available. Small loans can be offered since the program is enhanced by public sector dollars

5) A high standard of ability must be attained by the nonprofit corporation since private lenders make loans to business through the nonprofit, and the nonprofit guarantees repayment to the private lender.

This approach is novel but very effective. It provides for the proper incentives for lenders, nonprofits and rural businesses. It appropriately spreads the risk to businesses, nonprofits, private lenders and the federal government.

While there are problems with the NNC program described above, there too are problems with legislation now being considered. SBA 504 Debenture Programs are most effectively used in larger cities with larger projects since transaction costs are higher. The Rural Partnership Fund seeks private participation but could provide an incentive for lenders to utilize public funds to shore-up bad loans.

IV) Summary

In summary, rural economies are changing. We cannot stop change even if we so desired. We can, however, effectively manage this change to the advantage of rural areas.

New programs coming from Washington need to address the three main problems faced by rural business, management, marketing and finance. The most effective approach is through loans and grants made to capable nonprofits, where the risks are shared between businesses, private lenders, nonprofit corporations and the federal government.

I would like to thank the Committee for inviting me to offer this testimony and wish you well in your important deliberations.

Senator BAUCUS. Thank you, Mr. Kangas.

I have just one question. In your judgment, from a businessman's point of view, is the 50/50 match requirement in the bill a good idea? As you know, the legislation provides that nonprofits compete for up to $1 million in revolving loan funds from the SBA. One of the conditions for participation in the program is a 100 percent match from a private financial institution.

Do you think the private match is workable?

Mr. KANGAS. Well, I would say without knowing a lot of details that the private match is critical. It is not just important, it is critical to the effectiveness of the program.

The problem that I see with that type of program is that we can have private lenders pulling up $½ million or $1 million and the Federal Government puts up the other million.

There is, I think, a moral hazard problem where lenders might have problem loans that now, not only will they pony up $½ million, but they will find an avenue to use the public capital to take care of their problem loans. They are the ones that they look at the longest when they meet each week.

So that would be the only problem that I would see.

Senator BAUCUS. Don't you think that the competitive nature of the program would take care of that problem? In order to compete, nonprofits would have to demonstrate that they have procedures in place to deal with your concerns.

Mr. KANGAS. I think that would tend to eliminate the moral hazard problem that I talked about. I guess it was not clear to me when I read the bill as to what the competitive process really means and how you would rank that.

Senator BAUCUS. We would have to make sure bad loans are not placed on the backs of the Federal Goverment.

Senator Boschwitz.

Senator BOSCHWITZ. Thank you very much.

Mr. Kangas, let me ask a little bit about MMCDC. How much lending have you done, and what is your portfolio?

Mr. KANGAS. Well, we have been in business for 18 years. We have a portfolio of approximately 35 loans. Our total assets are slightly over $7 million. We consider on an average about $¼ million of new loans per month, which would average about $2 million per year.

Senator BOSCHWITZ. In loans?

Mr. KANGAS. In loans.

Senator BOSCHWITZ. What is the source of your capital?

Mr. KANGAS. We have several sources of capital: Private foundations; three different groups in Washington, EDA, two programs in Farmers Home, one being the Rural Development Loan Fund and another a new program called the Nonprofit National Corporation Loan Grant Program also out of Farmers Home Administration.

Senator BOSCHWITZ. Do you have any private capital at all?

Mr. KANGAS. Foundation capital, that would be private capital. Earnings from repayments according to certain grant agreements become private capital. That is private nonprofit capital which stays with the corporation.

Senator BOSCHWITZ. The money that you receive from governmental sources, is that in a revolving fund that you are allowed to keep in the fund and reloan it?

Mr. KANGAS. That is typically the case. In one instance we borrowed $½ million from Farmers Home. That has to be repaid over 30 years, I believe; but the majority of our capital actually comes from private sources. We have $9 million that we have agreed to borrow and relend in four different states—Minnesota, South Dakota, Nebraska, and Kansas—for which lenders receive an 80 percent guarantee and then we relend it to businesses in those States. If the business fails to repay, then it is our obligation to repay the banks.

So when I talked earlier about risk-sharing, that is what is happening. Businesses share the risk along with our organization and the banks, and since the banks receive a guarantee, they, too, share a risk.

Senator BOSCHWITZ. Could you tell me about the last three loans that you made?

Mr. KANGAS. The last three loans we made, Kenny's Candies, a company in Perham, MN, that uses agricultural products to manufacture things like licorice and various types of candies. We had a total loan out of about $300,000 to that enterprise. We have a loan to a lumber company.

Senator BOSCHWITZ. How many jobs were created up in Perham?

Mr. KANGAS. Well, I would say about 35.

Senator BOSCHWITZ. That is pretty good for $300,000; $8,000 per job.

The one before that?

Mr. KANGAS. We have a loan to a hardwood manufacturing company located in the small town of Menahga. We have a $100,000 line of credit and a $200,000 term loan to that business. They sell wood products to Canada and to Europe and Japan and also in the United States.

Senator BOSCHWITZ. Could you pull your microphone a little closer?

Mr. KANGAS. Then the third loan——

Senator BOSCHWITZ. How many jobs were created? Is that in Senator Kasten's State?

Mr. KANGAS. No. All of these are in Minnesota. It is not far from Detroit Lakes.

Finally, a rural business that makes a new product, something that has been invented within the last 12 months. It is a trailer for pickup trucks which can manually dump products. It is a little higher risk loan that we have taken on. That will probably create 10 to 20 jobs in the next 2 years as they expand their markets nationally.

Senator BOSCHWITZ. Thank you, Mr. Chairman.

Senator BAUCUS. Thank you very much, Mr. Kangas.

Senator Kasten.

Senator KASTEN. Mr. Chairman, I would like to yield first to the gentleman from Montana who was here at the hearing before me.

Senator BURNS. Thank you.

Mr. Kangas, I am familiar with the name of probably the most famous basketball coach in Montana, whose name was Mac

Kangas. He may have drifted down from Detroit Lakes for all we know. It seems like the migration has been across the northern tier.

Senator BOSCHWITZ. You have drifters out there? [Laughter.]

Senator BURNS. Yes, we have drifters everywhere. One of them happened to drift back east. I have been wetter this spring in Washington more times than I have in the last 20 years in Montana. I am going home one of these days.

I mentioned in my opening statement the number of programs that are already on the books to address these kinds of problems. You made reference to the fact that the FMHA already provides a lot of programs in their setup.

I know you have reviewed both of these bills, and I would like to get your opinion—should we as the Federal Government or the Small Business Administration or this subcommittee be directing our efforts into other areas?

Are we on the wrong track here with these two bills? I notice there are three shortcomings it seems like always pop up in rural areas. You mentioned the management experience, marketing, and capital formation.

Should we be directing our efforts toward maybe the first two on your priority list? I am just trying to set my priorities, if I could.

Mr. KANGAS. Well, I am a trained economist. I bypassed the State of Montana and went to the State of Washington and got my Ph.D. in economics, so a lot of my thinking is somewhat misguided in that respect since I am an economist.

Senator BURNS. I do not know how to take that. I will have to work that over.

Mr. KANGAS. I believe that the three problems are inextricably linked. You cannot separate management from marketing from finance. You must have all three of them to be successful.

Not every business faces the same problem, however. Successful businesses are going to meet all the criteria. They will be successful in management marketing and have access to capital.

Rural businesses face a problem whereby their market is now drifting away. People are migrating to cities. Aggregate demand is falling. Main Street businesses just cannot open the door and expect customers to walk in. Manufacturers have to look further and further to obtain their customers. They in fact have to look not just across many States but internationally, and that is going to become more of a problem rather than less of a problem.

Senator BURNS. We are also looking at some telecommunications legislation. Do you think maybe our efforts should be in transportation? If marketing is not in our little towns now and maybe even to the focal point which in the case in Minnesota where the major area is the twin cities as a market for a product, manufactured product.

I have thought for many years that Nebraska has always done a good job down there because in every one of those little towns in Nebraska it seems like they had one or two little manufacturing firms, that they tapped a very reliable labor force, and yet they keep perking along down there because they have sort of kept their small industry spread throughout the State.

I am wondering if we should be directing our efforts in developing that kind of an infrastructure for rural America.

Mr. KANGAS. I think the bill authored by Mr. Baucus does discuss technical assistance, and whether the intent there was to assist in terms of marketing and management, I am uncertain. I think the problem has been recognized, but very few programs actually deal with that element of business.

It is perhaps easier to write a loan agreement and sign a note. That is capital formation: A nonprofit gets a grant and lends it out and gets repaid or perhaps does not. It is more difficult to assess and to address the marketing and management issues.

Senator BURNS. Also in your type of operation, it appears to me that the cost of doing business is the cost of money. From the initial lender to the final user, am I off base in saying that you are a step that adds to the cost of that money in between those two people?

Mr. KANGAS. Well, we do not have much room to arbitrage. Only in one case do we arbitrage, and that is in the State of South Dakota where they have agreed to lend money to use at 3 percent and we have agreed to lend it at 4 percent.

In Minnesota, Nebraska and Kansas we are borrowing at prime plus 2 and relending at prime plus 2; thus, we are providing a service basically for those banks and guaranteeing repayment to those banks. There is a carrot for us in this, however, in that Farmers Home has provided actually a $5 million grant, $3 million of which we have set aside to use as a revolving loan fund.

So after all the loans are repaid, we are going to have a $3 million revolving loan fund, so it does not add to the cost of an individual business except in South Dakota, but that is already relatively inexpensive for the businesses there.

Senator BURNS. I have no further questions. Thank you, Mr. Chairman.

Senator BAUCUS. Thank you very much, Senator.

Thank you, Mr. Kangas.

Senator Kasten.

STATEMENT OF HON. ROBERT W. KASTEN, JR., A U.S. SENATOR FROM THE STATE OF WISCONSIN

Senator KASTEN. Mr. Chairman, first of all let me just make a brief statement. I know that every Member of our Subcommittee has regions of our State which are overwhelmingly rural, and when an economic downturn or stagnation has hit these regions, it is a difficult and daunting task to get them back on the road to growth and prosperity.

Our Subcommittee stands ready to consider any sound proposal which would serve to jumpstart rural America.

Today we have two proposals before us, Mr. Chairman, your S. 863, Rural Access to Capital Act, and S. 1051, Senator Boschwitz' Small Business Rural Revitalization Act. I am a co-sponsor of S. 1051, which I feel is a creative and fiscally sound initiative, but I think one thing that is clear is that no one piece of legislation is going to solve the problems of rural America.

Before this Subcommittee can adopt measures designed to tackle these problems, we have to make certain that we fully understand their nature and their scope. This open discussion of the serious economic problems of rural areas and the possible ways for this Subcommittee to help alleviate them is going to be very helpful.

I have three different kinds of questions which I would like to ask, and I am not sure either one of you could help. I do not mean to talk specifically with any one.

The first, Mr. Kangas, is what is the scale shortage of rural workers? In other words, if we create new, more advanced jobs in rural areas, do the workers have the necessary skills to fill them, or do we also need to examine our Nation's vocational education programs and other forms of education programs in order to see that we have these skills available?

As you may know being from Minnesota, we have a lot of economic development right now going on in the western part of our State in Eau Claire and Chippewa Falls, and we have a major skill shortage problem. You walk into a McDonald's and it says "No Shoes, No Shirt, No Service" and "Help Wanted". We have it at all different levels.

I do not want to talk about the employment/unemployment question. I want to talk about the skills question. I would be interested in what we think is going on in Arkansas as well.

Senator BAUCUS. Mr. Doose, would you like to answer that please. Then, I would like you to proceed with your statement.

Senator KASTEN. Mr. Chairman, I apologize. I thought each witness had spoken.

Senator BAUCUS. Ordinarily that is the procedure.

Mr. DOOSE. I think in Arkansas we are in fact faced primarily at this stage with an excess labor supply. Unemployment/underemployment is a tremendous problem. We have not yet gotten to the stage where there are help wanted signs appearing on every storefront in the community.

I think that the major challenge in the dimension of improving the skills of the labor force is in fact matching up the enterprise development side with the skill development side, so that the vocational institutions do not produce people that possess skills that cannot be applied in rural areas and then are faced with the decision of moving to the urban centers to apply those skills in some meaningful fashion.

In like manner, without an enterprise there is no opportunity to apply skills and no need to really develop the skills in either. So it is the process of connecting the two that I think is difficult.

Senator KASTEN. In your part of the country right now you do not have a shortage of skills; you have a shortage of jobs?

Mr. DOOSE. That is correct.

Mr. KANGAS. I think in the State of Minnesota we have a very good educational system, as in Wisconsin and many other States nearby. There still needs to be an investment, however, in improving those skills. I could mention a couple of examples.

A steel manufacturer in Montevideo, which is in southern Minnesota, basically contracted with the local technical institute to provide the necessary skills that match what he needs. He will provide the training.

A less than High-Tech Manufacturing Company, which manufactures draperies in northern Minnesota, has set up their own training facilities to augment what the technical institutes have done in terms of telephone sales, in terms of selling, and development of managerial talent. So they have taken on the educational process themselves to augment what the technical institutes cannot provide.

Senator KASTEN. That is happening in many cases in our State, too, right now.

Let me just switch direction. The two different bills that we are talking about today—and I am sure there are other bills in the House of Representatives and maybe even in the Senate—are concentrating on two basic areas. No. 1, is the need to improve access to capital, and No. 2, is the need to eliminate regulatory roadblocks to small business, the idea that small business has got to work its way through these different kinds of regulatory roadblocks.

Are we right? Are these the two major problems in rural America, access to capital and regulatory roadblocks; or is there something more that we should look at?

Mr. KANGAS. Well, I think the main problem business has always faced is profits. The question is what prevents a business from making profits. Is it taxes? Is it the ability to raise revenues through marketing their product? Is it some regulation that causes them to pay high cost for the labor or for cleaning up the environment?

There are a lot of different issues, but the bottom line, Senator, is that they must have profits. I would imagine there are a lot of things that go into profits which I do not know that you or I can solve.

Senator KASTEN. But you can solve or I can solve or we can legislate. We certainly cannot legislate profits. We might be able to legislate the repeal of section 89 of the Tax Bill. We might be able to legislate a capital gains tax cut.

There are things we can legislate, but are you saying that access to capital and the regulatory roadblocks are two things that we need to deal with?

Mr. KANGAS. I think they can and should be dealt with. I am not familiar with the regulations that businesses face. I concentrate on access to capital, and I do see that there is a problem for rural areas accessing capital. That is moving to larger areas and to other banks.

Senator KASTEN. Mr. Doose, do you have any comments?

Mr. DOOSE. My own reaction would be that maybe the principal challenges are in the dimension of conceiving and executing viable business enterprises. That is another area that is unaddressed by the bills and certainly a major issue that I think rural areas are facing. It is more than just the technical assistance provided in conjunction with financing. It is the process of creating the idea for a business and then helping them do whatever is required to make that business go.

The other issue is in the capital dimension, but I think it is more an issue of whether the right kind of capital is available and not the total dollar amount of capital available.

I think there is lots of debt capital available in rural areas. There is not enough equity, and that is the critical piece that is chronically missing across this country, I think.

Senator KASTEN. Mr. Chairman, thank you.

Senator BAUCUS. Thank you.

Mr. Doose, please proceed with your statement?

STATEMENT OF JEFFREY A. DOOSE, PRESIDENT, SOUTHERN VENTURES, INC., ARKADELPHIA, AR

Mr. DOOSE. Mr. Chairman and distinguished Members of the Subcommittee, it is my pleasure and honor to be here today to talk about rural capital formation. I sit before you as a product of rural America. I was born and raised on the prairies of southwestern Minnesota and have spent most of my professional life on rural development issues. In fact, I was with Mr. Kangas' organization—midwest Minnesota—in the early 1970s. I have also worked in Colorado, Mississippi, and now Arkansas.

I care deeply about the future of rural America, and I am convinced that effective steps can and must be taken at the Federal level to improve the performance of the rural economy.

My testimony here today is intended to first provide some background information on the organization with which I am presently associated; second, to provide some general observations about rural development and rural capital formation; and third, to offer some suggestions regarding legislation now pending before the Subcommittee.

The organization I am working with now is Southern Development Bank Corporation, of which Southern Ventures, the component I head up, is a part. This organization began operations in May 1988, as a privately-owned and privately-capitalized development bank.

The organization was founded on the premise that economic activity and job formation can be increased in a rural setting by providing resources and creating a culture that encourages new business formation, expansion, and innovation.

Southern is designed to be a strong permanent self-sustaining institution capable of carrying out a long-term program of economic development with a sense of urgency and creative resourcefulness.

It is a "third sector" institution—a catalyst for mobilizing and constructively applying resources from both public and private sectors for the purpose of rural economic development. Its main components include a commercial bank which is involved primarily in the provision of development credit—using SBA and Farmers Home guarantees—and also conventional credit to small rural enterprises.

The organization also includes a for-profit real estate development company called Opportunity Lands that participates with local companies in assembling and developing properties for use as business incubators, low- and moderate-income housing, industrial facilities and other similar purposes.

We have a for-profit small business investment company called Southern Ventures that makes equity and debt investments in locally-owned companies.

We have a Seed Capital Fund that makes loans or equity investments for product, management, and market development.

We have a not-for-profit micro enterprise loan fund called the Good Faith Fund that utilizes peer group organizing and credit discipline techniques to provide very small, under $5,000, short-term—less than 1 year—loans to local residents who are involved in self-employment activities.

We have a not-for-profit development corporation called Arkansas Enterprise Group, that provides analysis, management, and financial support services to entrepreneurs and business operators throughout the region.

We also expect to, within the next 12 months, begin an intermediary relending program in cooperation with the Farmers Home Administration.

In our first year of existence we have made some pretty good progress, I think. Southern Ventures has invested a little over $\frac{1}{2}$ million in three local businesses, and we expect to invest about $1.3 million in the next 6 months.

Our bank has provided $150,000 in development loans and will probably close on more than $1 million in loans in the next 6 months.

The Good Faith Fund has provided nearly $50,000 in loans to 16 micro businesses.

The Seed Capital Fund has provided more than $100,000 in financing, and our support programs in the Arkansas Enterprise Group are now off and running.

Senator BOSCHWITZ. So you have just begun?

Mr. DOOSE. We are just starting. Yes, we are just a little over 1 year old.

There are several lessons that I have learned over the years, and most of these lessons have been confirmed so far by experiences in Arkansas.

First is that the creation of permanent catalytic resourceful institutions capable of designing and implementing effective development strategies in rural areas is absolutely essential. These will often be "third sector" institutions, privately chartered but oriented toward public purposes, market disciplined in the sense that if they consistently make bad investment decisions they will go out of business.

They possess highly skilled and competitively compensated staff people with real world skills in business operations, management, marketing, and finance. They are insulated to the maximum extent possible from superfluous political influences on their investment decisions.

Across rural America there is a decided shortage of organizations of this type, be they development finance organizations, community development corporations, small business investment companies. There is just not enough of this infrastructure in place.

Second, the creation of permanent, self-sustaining mechanisms to improve capital flows in rural areas is essential. However, part of the problem currently is that there is too much of the wrong kind of capital (debt), too little of the right kind (equity), and too little capacity to effectively and resourcefully apply either. Equity capital for early stage capitalization situations is especially needed.

Third, Capital is a necessary, but not sufficient ingredient for enterprise formation and development. Attention must also be focused beyond capital to issues of entrepreneurial and managerial development access to markets and raw materials, and improving the capacity for innovation.

Fourth, development strategies for utilizing risk capital in rural areas must employ appropriate scale, intensity, and targeting strategies: Diversification, elaboration, and innovation, particularly of the economic base in these rural communities, is of primary importance.

Fifth, the purpose of rural development initiatives in the near term should be to increase the rate of enterprise formation and survival, but in the long term the objective should be to transform the rural economy, thereby affecting issues of output, distribution, and entrepreneurial attitude. In other words, development is not just a process of counting noses, counting jobs, counting loans, but determining whether the strategies have made a difference in that particular rural community.

Sixth, principal tenants of a rationale for Federal involvement in rural development are to invest, not to spend; to promote competitiveness; to equalize opportunity; and to capitalize on existing assets. But Government and Government agencies at all levels generally have a poor record of separating winners from losers in the allocation of financial resources for business development. Therefore, the Government role should be to "wholesale" resources—with streamlined regulations—to intermediary "third sector" type institutions who would then "retail" assistance to business enterprises. This approach is must much efficient and ultimately much more effective.

Seventh, Federal Government resources should never be used in a bidding war of subsidies for industrial locations. Unfortunately, this happens too much, and it happens a lot in rural areas.

Suggestions on legislation now pending. Based upon these lessons, I would offer the following general and specific comments. Some general comments first.

A high premium should be placed on coordinating all of the rural development initiatives now pending in Congress. If it is possible to combine the resources contemplated under the various bills before the Senate Agriculture and Small Business Committees, some $330 million plus by my reckoning, to create a permanent, self-sustaining, independent rural development finance bank, that alternative should be pursued.

This bank should be structured along the lines of the Federal National Mortgage Association or the oft-discussed but never finalized Corporation for Small Business Investment.

If sufficient resources are not available, the strategy to get us from here to there should be designed, and intermediate steps consistent with that strategy should be taken.

Consideration should be given to other techniques in addition to direct Federal funding that could work in parallel with the proposed bills. Changes in the Tax Code—such as lower capital gains rates, tax deductions or credits for investments in small business or institutions that finance small, rural businesses—are possible avenues.

Focus more attention, especially in competitive scoring and administration, on the creation of permanent, catalytic, resourceful local institutions and on strategies and work plans that bring together the ingredients necessary for success in rural development.

Some specific comments on S. 863. I think within title I on the program scale contemplated—$30 million—the use of funds should be modified to provide only equity or near equity to eligible businesses. This is the type of capital most needed in rural areas and would also help mobilize existing debt resources.

Section 103(c), competitive scoring should be weighted heavily toward applicant's capacity and experience in making capital investments in small rural businesses. Scoring should also be weighted heavily toward applicant's experience and capacity in providing real world technical assistance.

In section 101(3), eligible businesses should be unable to secure "adequate" credit. This change would clarify that many businesses might qualify for some credit but not at an adequate level.

In section 101(4), the definition of rural community, my vote on that issue would be that the definition focus on areas outside of cities of more than 50,000 people with population densities of less than 100 persons per square mile.

Perhaps more importantly, applicants should also be required to identify a service area in their application. The service area would be required to meet certain threshold criteria related to factors such as income and unemployment with perhaps some additional points scored for service areas that are experiencing out-migration or other conditions.

Scoring of the work plan would relate, in part, to the selection and description of the needs of the target area and the scale, intensity, and targeting of the development strategy.

Section 103(a), loans only are authorized, but the rate and terms have not been established on loans from the Federal Government to the borrower. Clearly, the rate should be low enough to accommodate technical assistance provisions out of the spread. A grant approach, however, would greatly simplify administration, would facilitate equity investments to the ultimate borrowers—the small businesses—and cost only marginally more in present value terms than a loan at, for example, 1 percent over 30 years.

In title II, once again I think the reference should be to "adequate credit" in section 201(3).

In section 201(4), the maximum size for micro businesses I would say should be five employees.

In section 204(6), the maximum loan size should be $10,000. Other Federal programs, particularly the Farmers Home Administration Intermediary Relending Program, can effectively service businesses with more than five employees and financing needs for more than $10,000.

Section 202(a) I would say the transaction should be a grant to the eligible applicant, not a loan.

In section 203(d), competition should be weighted heavily toward capacity and experience once again, in this case in micro enterprise lending and technical support.

On S. 1051, title I, section 101(d), I would suggest the same definition of rural be used as is suggested in S. 863.

In section 102, changes to allow contributions by State and local governments and not-for-profit institutions are some potential help but only if those funds are available for leverage through the existing SBIC Program. The question is whether such institutions will be motivated to make such contributions. I am not sure that they have adequate incentive to do so.

In section 104(c), the emphasis should once again be on equity or near equity investments in small businesses.

In titles II and III there might ultimately be some help here; however, in my opinion lack of access to Federal markets and lack of access to incubator facilities are not presently the most significant impediments to rural enterprise formation and development.

That concludes my comments. I would like to thank you for the opportunity to submit the testimony. Rural development is an issue of immense personal and professional interest to me, and I commend the subcommittee for its interest in this topic and stand ready to assist you and your staff in any way that might be helpful in improving the conditions of rural America.

[The prepared statement of Mr. Doose follows:]

Testimony before
United States Senate
Subcommittee on the Rural Economy
and Family Farming
Committee on Small Business

Relative To:

Rural Capital Formation

Given By:

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Date of Testimony

June 9, 1989

STAMEMENT OF JEFFREY A. DOOSE, PRESIDENT
Southern Ventures, Inc., Arkadelphia, Arkansas

Mr. Chairman and distinguished members of the Subcommittee. I sincerely appreciate and am deeply honored to have this opportunity to appear before you to offer testimony on rural capital formation.

I am a product of rural America. I was born and raised on the prairies of southwestern Minnesota, and have spent all of my professional life working on rural development issues in Minnesota, Colorado, Mississippi and Arkansas. I care deeply about the future of rural America and am convinced that effective steps can and must be taken at the federal level to improve the performance of the rural economy.

My testimony here today is intended to first provide you with some background information on the organization with which I am presently associated; second, provide some general observations about rural development and rural capital formation; and third offer some suggestions regarding legislation now pending before the Subcommittee.

Southern Development Bancorporation

Southern Development Bancorporation, of which Southern Ventures is a part, began operations in May of 1988 as a privately owned and privately capitalized development bank. The organization was founded on the premise that economic activity and job formation can be increased in a rural setting by providing resources and creating a culture that encourages new business formation, expansion and innovation. Southern is designed to be a strong, permanent, self-sustaining institution capable of carrying out a long-term program of economic development with a sense of urgency and creative resourcefulness. It is a "third sector" institution--a catalyst for mobilizing and constructively applying resources from both the public and private sectors for the purpose of rural economic development.

Components of the organization include:
-a for-profit commercial bank, the Elk Horn Bank, that provides development credit (primarily with SBA and FmHA guarantees) and conventional credit to small

rural enterprises;
-a for-profit real estate development company, Opportunity Lands Corporation, that participates with local companies to assemble land and develop properties for use as business incubators, low and moderate income housing, industrial facilities, and other similar purposes;
-a for-profit Small Business Investment Company, Southern Ventures, Inc., that makes equity and/or debt investments in locally-owned companies;
-a not-for-profit Seed Capital Fund, that makes loans or equity investments in small businesses for product, management, and market development;
-a not-for-profit micro-enterprise loan fund, the Good Faith Fund, that uses peer groups organizing and credit discipline techniques to provide very small, short-term loans to local residents interested in self-employment;
-a not-for-profit development corporation, the Arkansas Enterprise Group, that provides analysis, management, and financial support services to entrepreneurs and business operators throughout the region;
-a not-for-profit Intermediary Relending Program, is also expected to begin operation within 12 months.

In the organization's first year of operation, significant progress has been made. Southern Ventures has invested over $550,000 in three local businesses and expects to invest $1,300,000 more in the next six months. The Elk Horn Bank has provided nearly $150,000 in development loans, and expects to close more that $1,000,000 in loans in the next six months. The Good Faith Fund has provided nearly $50,000 in loans to 16 micro-businesses; the Seed Capital Fund has provided more than $100,000 in financing; and the support programs of the Arkansas Enterprise Group are becoming fully operational.

Observations Concerning Rural Development

Several lessons have been learned over my many years in rural development and have been confirmed so far by Southern's experiences in Arkansas:

1) The creation of permanent, catalytic, resourceful institutions capable of designing and implementing effective development strategies in rural areas is absolutely essential. These will often be "third sector" institutions, privately

chartered but oriented toward public purposes; market disciplined in the sense that if they consistently made bad investment decisions they will go out of business; possessing highly skilled and competitively compensated staff people with real world skills in business operations, management, marketing, finance; and insulated to the maximum extent possible from superfluous political influences on its investment decisions. Across rural America, there is a decided shortage of organizations of this type (comprehensive development finance organizations, community development corporations, SBIC's).

2) The creation of permanent, self-sustaining mechanisms to improve capital flows to rural areas is also essential. However, part of the problem currently is that there is too much of the wrong kind of capital (debt), too little of the right kind of capital (equity), and too little capacity to effectively and resourcefully apply either. Equity capital for early stage, low capitalization situations is especially needed.

3) Capital is a necessary, but not sufficient, ingredient for enterprise formation and rural development. Attention must also be focused beyond capital to issues of entrepreneurial and managerial development, access to markets and raw materials, improving the capacity for innovation.

4) Development strategies for utilizing risk capital in rural areas must employ appropriate scale, intensity, and targeting strategies. Diversification, elaboration and innovation, particularly of the economic base, is of primary importance.

5) The purpose of rural development initiatives, in the near term, should be to increase the rate of enterprise formation and survival, but in the long term the objective should be to transform the rural economy, thereby effecting issues of output, distribution and entreprenurial attitude.

6) Principle tenets of a rationale for federal involvement in rural development are to invest not spend, to promote competitiveness, to equalize opportunity, to capitalize on existing assets. But government and government agencies at all levels generally have a poor record of separating winners from losers in the allocation of financial resources for business development. Therefore, the government role should be to "wholesale" resources (with streamlined regulations) to intermediary "third sector" type institutions, who would then "retail" assistance to business enterprises.

7) Federal government resources should never be used in a

bidding war of subsidies for industrial locations.

Suggestions on Legislation now Pending

Based on these lessons, I would offer the following general and specific comments regarding the legislation on rural capital formation now pending before the Subcommittee.

General Comments

1) A high premium should be placed on coordinating all the rural development initiatives now pending in Congress. If it is possible to combine the resources contemplated under the various bills before the Senate Agriculture and Small Business Committee (some $330+ million by my reckoning) to create a permanent, self-sustaining, independent rural development finance bank, that alternative should be pursued. This bank could be structured along the lines of the Federal National Mortgage Association or the oft-discussed Corporation for Small Business Investment. If sufficient resources are not available, a strategy to get from here to there should be designed, and intermediate steps consistent with that strategy should be taken.

2) Consideration should be given to other techniques in addition to direct federal funding, which could work in parallel with the proposed bills. Changes in the tax code (such as lower capital gains rates, tax deductions, or credits for investments in small businesses or institutions that finance small/rural businesses) are possible avenues.

3) Focus more attention, especially in competitive scoring and administration, on the creation of permanent, catalytic, resourceful local development institutions and on strategies (workplans) that bring together all the ingredients for success in rural development.

Specific Comments - S 863

1) Title I - Section 103(a)(1): At the program scale contemplated ($30 million), the use of funds should be modified to provide only equity or near equity to eligible businesses. This is the type of capital most needed in rural areas, and would also help mobilize existing debt resources.

2) Title I - Section 103(c): Competitive scoring should be weighted heavily toward applicant's capacity and experience in

making capital investments in small, rural businesses. Scoring should also be weighted heavily toward applicant's experience and capacity in providing real world technical assistance.
3) Title I - Section 101(3): Eligible businesses--should be unable to secure "adequate" credit. This change would clarify that many businesses might qualify for some credit but not at an adequate level.
4) Title I - Section 101(4) : Definition of rural community- substitute a definition based on areas outside cities of more than 50,000 people, with population densities of less than 100 persons per square mile. Applicants should also be required to identify a service area in its application. The service area would be required to meet certain threshold criteria related to such factors as income and unemployment, with a modest number of extra points awarded if the service area is experiencing outmigration or other conditions. Scoring of the workplan would relate, in part, to the selection and description of the needs of the target area and the scale, intensity and targeting of the development strategy.
5) Title I - Section 103(a): Loans only are authorized, but the rate and terms have not been established. Clearly, the rate must be low enough to accommodate technical assistance provisions out of the spread. A grant approach would greatly simplify administration, would facilitate equity investments, and cost only marginally more (in present value terms) than a loan at, for example, 1% over 30 years
6) Title II, Section 201(3): Amend to refer to adequate credit.
7) Title II, Section 201(4): Maximum size for micro businesses should be 5 employees. Section 204(6): maximum loan size should be $10,000. Other federal programs, particularly the FmHA Intermediary Lending Program, can effectively service businesses with more than 5 employees and financing needs of more than $10,000.
8) Title II, Section 202(a): Should be a grant to the eligible applicant, not a loan.
9)Title II, Section 203(d): Competition should be weighted heavily toward capacity and experience in micro-enterprise lending and technical support.

Specific Comments - S 1051

1) Title I, Section 101-(d): Would suggest use of same definition of "rural" as recommended in S 863.

2)Title I, Section 102: Changes to allow contributions by state and local governments and not-for-profit institutions are of some potential help. The question is whether such institutions will be motivated to make such contributions.
3) Title I, Section 104(c): Emphasis should be on equity or near equity investments in small businesses.
4) Titles II and III may ultimately be of some help in expanding rural business enterprises. However, lack of access to federal markets and lack of access to incubator facilities are not presently the most significant impediments to rural enterprise formation and development.

Thank you for the opportunity to submit this testimony. Rural development is an issue of immense personal and professional interest to me. I commend the Subcommittee for its interest in this topic, and stand ready to assist you and your staff in any way that might be helpful in improving the condition of rural America.

Senator BAUCUS. Thank you, Mr. Doose. It is clear from your statement that not only have you given a lot of thought to the problem but you also have a great deal of experience in this area. Your list suggestioned modifications of each of the bills is very comprehensive. I will consider them thoroughly as final drafts are prepared. I appreciate all your work.

Senator Boschwitz.

Senator BOSCHWITZ. I join you, Mr. Chairman, in that. Really, that is the purpose of these hearings, to get people who have more on-the-scene knowledge to make an analysis.

I noted when you began to speak that you did not sound like you were from Arkansas. Where are you from? I am not sure if that is a compliment or just an observation. Where are you from in Minnesota?

Mr. DOOSE. I am from southwestern Minnesota.

Senator BOSCHWITZ. You apparently do not agree with Mr. Kangas from the standpoint that all of the funding, all of the help should go through a nonprofit type of situation alluded to in Mr. Kangas' testimony. Am I correct in that observation?

Mr. DOOSE. I think perhaps not. What I am talking about is the critical nature and role of this intermediary institution. Community development corporations such as Midwest Minnesota are often chartered as not-for-profit corporations that have for-profit subsidiaries.

Our organization is a for-profit bank holding company with nonprofit-affiliated organizations. The legal structure is different, but the purpose and the actions that these institutions, these intermediary institutions, take are very similar. I would agree with Mr. Kangas that their role is pivotal.

Senator BOSCHWITZ. Let me in a way change the subject just a little bit. We are considering here in the Congress so-called Section 89, and I presume that both of you have a good working familiarity with it.

Senator Kasten led the fight to eliminate Section 89 entirely and start over again without being terribly critical of its goals. One of the representations that has been made by some of the opponents that was a little different in my experience is that there are different types of medical plans that apply to management and that apply to the other people in the company.

Both of you in your experience have seen a number of firms. Would you comment as to whether there is a need to regulate in some detail the type of medical plan extra plan of one type or another that is received by employees and businesses you had an association with, or are the plans fairly uniform for all the employees in those businesses?

Mr. DOOSE. I think in our experience in Arkansas at least, the principal problem is that so few employees are covered by any fringe benefit plan at all that Section 89 is almost a nonissue.

Senator BOSCHWITZ. In the businesses that you have been associated with since you have been with the——

Mr. DOOSE. In the main, across Arkansas and in many southern States, there is a decided lack of availability of fringe benefit plans, health plans, and so forth, for these small businesses. That is a

critical problem. Illness has a devastating effect on a family, and it is an area that needs and deserves some attention.

I think the problem with Section 89, however, as it is presently structured, is that it has introduced such a level of uncertainty and administrative complexity that it is almost beyond the capacity of the average small businessman to know what he is getting into, what he needs to do to effectively comply with the regulation. I think that is the problem.

There is a need——

Senator BOSCHWITZ. Well, the need that you find is somewhat different, and it is not a Section 89 need as much as it is a need to obtain coverage for some of these very small businesses.

In the loans that you have made and the business that you have seen established, do most of them have medical plans?

Mr. DOOSE. The larger scale enterprises that we finance——

Senator BOSCHWITZ. What does "larger scale" mean? Ten or more?

Mr. DOOSE. Companies that have at least 10 employees will generally have health plans. Micro enterprises are generally self-employment situations. The principal in the company is the only employee, and of course they generally do not have health plans of any kind.

Senator BOSCHWITZ. What is your experience, Mr. Kangas? Making a comment on Section 89 first, do most of the companies in which you invest have health plans?

Mr. KANGAS. Very few. I have been sitting back trying to think of one of the businesses that we deal with that might have a problem with Section 89, because very few benefits are ever provided for their employees. They would be happy to provide additional wages, and the employees would much rather have the additional wages perhaps than added benefits.

Senator BOSCHWITZ. This new company in Perham, for instance, where you have 35 employees, do they have any kind of a benefit package?

Mr. KANGAS. Perhaps for the managerial staff, but I would be quite certain that the individuals are not covered.

Senator BOSCHWITZ. So in that case, then, Section 89 would apply to that firm because you could not have it for the managerial staff——

Mr. KANGAS. Then I may be mistaken in terms of management. I do not know that that is a problem for them. Very few companies, as I said, have benefits whatsoever.

Senator BOSCHWITZ. What about the minimum wage, something we are also considering. What would the rise in the minimum wage do?

One of the things that I said on the Floor of the Senate in opposing the minimum wage rise to $4.55 and supporting the President's $4.25—though I do not think it makes much difference, to be quite honest—is why not raise it to $8 or $10, and then everybody will make a wonderful minimum wage, and everybody should be happy.

The reason you do not raise it to $8 or $10 is that there would be a lot of economic displacement and a lot of lost jobs.

I wonder if you would comment about the impact of a rise in the Federal minimum wage and whether or not it would make it more

difficult for these firms that you are putting into place either in Arkansas or Kansas or South Dakota or Minnesota.

Mr. KANGAS. I have two comments. First, the minimum wage is not $3.25, it is not $4.25, it is not $5 an hour. The minimum wage is $0 per hour. Those are the people who cannot find jobs. They make $0 per hour.

In terms of an impact on the clients or the businesses that we deal with, there would be very little. Typically, the people we make loans to are manufacturers. Typically, the wages are above what the minimum wage would be. You would find more of an impact in service-related business, perhaps Main Street business, where younger people who would have more difficulty in finding jobs as a result.

Senator BOSCHWITZ. Where is Menahga? Up by Detroit Lakes?

Mr. KANGAS. Yes.

Senator BOSCHWITZ. I get that mixed up with the one in Wisconsin.

The lumberyard is where?

Mr. KANGAS. It is in Menahga.

Senator BOSCHWITZ. That is 10 jobs, and at what rate are those folks starting?

Mr. KANGAS. I would guess something in excess of $5 per hour.

Senator BOSCHWITZ. And in Perham?

Mr. KANGAS. I would say around $4.50.

Senator BOSCHWITZ. In the Twin Cities where we operate and in Madison, Milwaukee, Indianapolis, and Des Moines, if you make the minimum wage of $5, it would not make any difference because you hire people above that anyway.

So you do not think the impact of raising the minimum wage is going to have any constrictive impact or effect upon the companies that you are financing?

Mr. KANGAS. There would not be a direct impact. There might be some subsequent impact, but I do not think it would be noticeable.

Senator BOSCHWITZ. But you are mostly involved in manufacturing businesses?

Mr. KANGAS. That is correct.

Senator BOSCHWITZ. I wonder if you would comment, please, Mr. Doose.

I really join the Chairman in saying that both your testimonies are helpful to us, and I appreciate the depth of your analysis.

I do not know, Mr. Chairman, what Mr. Doose meant by superfluous political influences. That is something you and I are not involved in. I think maybe we had better not comment on that, but would you comment on minimum wage and as to whether or not you feel the rise in minimum wage will have any adverse effects on what you are trying to achieve?

Mr. DOOSE. It will have little direct effect on what we are trying to achieve. We consider one of our major objectives to be to try to introduce 21st Century enterprises into rural areas—companies that can generate substantial gross margins to support decent wages within their cost structures and still be competitive in the worldwide marketplace. So it has little direct effect on us.

However, I think there will probably be a displacement effect in many of the rural communities in our service area primarily be-

cause there is a substantial segment of the economic base that is devoted to low wage manufacturing, and the likely impact there is that jobs could and probably would over time be shifted to lower wage manufacturing environments around the globe. So there would be that effect.

Senator BOSCHWITZ. That was the fear that I stated on the floor. One, rural areas have few advantages in competing for new businesses, and that one of their advantages was that the wage base is lower. The cost of living, on the other hand, is by and large lower, particularly the cost of shelter.

I was interested in your comments.

I thank you, Mr. Chairman.

Senator BAUCUS. Thank you, Senator Boschwitz.

Senator Burns.

Senator BURNS. Mr. Doose, thank you very much for coming today. I see that the move from southwestern Minnesota to Arkansas has sort of cleaned up your language. [Laughter.]

It is getting better. We can understand you now.

Senator BOSCHWITZ. Mr. Chairman, can you not control these Members? [Laughter.]

Senator BURNS. I would have one question of you. Do you have any idea on what other communities can do or maybe we should be doing to get them to take the same initiative that Arkadelphia, AR, has taken to provide organizations such as yours for the rural communities?

I am getting the feeling here that enough programs are in place. We are just not placing our emphasis in the right direction.

Do you have any ideas on what we should do to get other communities to take the same initiative that you have taken?

Mr. DOOSE. One clarification that should be made is that the local community, in this case, was certainly supportive but did not take the initiative in creating the organization. We were primarily an initiative that was triggered by a philanthropic organization in the State that wanted to test the idea of whether a development bank could have a favorable impact on rural development issues. Arkadelphia was the community in which we acquired the bank, so that is why we are there.

I think the major thing that needs to occur is that there just needs to be more awareness that there are other alternatives and other techniques and instruments through which economic development, particularly in rural areas, could occur.

The fact that you are holding these hearings is a step in the right direction. If organizations such as these, such as Midwest Minnesota and Southern Development Bancorporation could be beneficiaries of programs such as these that are being introduced, it will enhance our capabilities. Others may become aware of what we are doing. That sort of demonstration effect ultimately may be the way through which this approach is shared.

Senator BURNS. Again, thank you, Mr. Chairman, very much, and I want to thank these two gentlemen. I think your testimony has been excellent and we have derived a lot of ideas. You have brought some things to the awareness of this Senator particularly and this subcommittee. I appreciate that very much.

Thank you very much.

Senator BAUCUS. Thank you very much, gentlemen, for your testimony.

Our final panel consists of Mr. Terrence Stone from Mankato, MN; Mr. Richard Palank from the National Association of Development Companies in Washington, DC; and Mr. John Jackson, general counsel of the Minnesota Bankers Association, Minneapolis, MN.

I will ask each witness to give his statement, and we will proceed to questions after all of the witnesses have concluded their statements.

I urge each witness to summarize the main points of your testimony. Please proceed.

STATEMENT OF TERRENCE F. STONE, EXECUTIVE DIRECTOR, REGION NINE DEVELOPMENT COMMISSION, MANKATO, MN, ON BEHALF OF THE NATIONAL ASSOCIATION OF DEVELOPMENT ORGANIZATIONS

Mr. STONE. Mr. Chairman, Senator Boschwitz, and other Members of the Subcommittee on Rural Economy, I am Terrence Stone, the executive director of the Region Nine Development Commission located in Mankato, MN. I am the first vice president of the National Association of Development Organizations, or NADO.

I would like to thank you for your interest in improving the flow of capital to small businesses in rural areas. Without adequate financing resources, small businesses will not be able to survive or expand in rural areas. I commend your efforts in addressing this important issue.

As executive director of the Region Nine Development Commission in Mankato and as a former small businessman and a former rural elected official in a town of 2,200, I am all too familiar with the problems of small business financing in rural areas.

Today I am testifying not only from my personal and professional experience but also as a representative of the National Association of Development Organizations. My comments reflect the concerns of rural development professionals from across the Nation.

The National Association of Development Organizations was founded in 1967 to maintain and create jobs in small metropolitan and rural communities. NADO's members are substate multicounty planning and development organizations.

These public purpose institutions are the development professionals who work with local governments and the private sector to promote business community and economic development. We are really the grassroots network that is dedicated to improving economic opportunities and quality of life for all of rural America.

I think that one of the things I have heard this morning is that we cannot change what is happening in the world, and we ought to buy into the fact that we are going to have these people displaced. Definitely in my agency and I think in most of our development organizations that is not the tact that we take.

We are working to keep our rural population in rural Minnesota. The way we feel that we can do that is to create jobs, good jobs, in our area, in the local area rather than moving people to the urban areas.

I have maintained for a number of years and am now being proven right in our area of the State that no community is going to die unless they want to. If those people get themselves together, do good community organization and set their own priorities and then go forth from there with assistance from an organization like ours. they become very effective, and they can continue to live as a community.

I will skip over some of this because we are getting short of time. You have all of the written testimony there.

I would like to talk a little bit about the Region Nine Development Commission. We are an umbrella agency or a multi-purpose planning and development organization in south central Minnesota. We are involved as a certified development corporation for SBA We have done approximately 20 loans. Our portfolio in that particular instance runs close to $5 million.

We also assist businesses in putting together 7(a) applications. I think, again, we are talking about close to another $3 or $4 million. So we are very experienced in having local elected officials, local financial people, bankers, local economic development professionals, and local folks helping us make decisions about who should get those loans. It is a very professional staff that has a very good record as far as being able to make good loans and then service those loans.

Urban and rural distinction, we often hear of a bicoastal economy with middle America missing its opportunities for economic growth. I do not think that is necessarily true. The true dichotomy is the urban/rural split. Rural America has not kept up with urban economic expansion. As the Wall Street Journal so accurately noted in an August 4, 1988 article, metropolitan America is wallowing in nervous prosperity. Times are so good that people are afraid they cannot last. In the other America, the forgotten one beyond the patches of urban and suburban wealth, people would like the chance to be afraid about good times lasting.

As you know, small business's growth in rural areas has been outpaced by such growth in urban areas. The problem is not a lack of rural entrepreneurs but, rather, inadequate financing resource management assistance for rural small businesses.

All too often it seems that rural America has been forgotten. The small business financing mechanisms have developed a distinct urban orientation.

These revolving loan funds are a very much needed investment. In my capacity as vice president of NADO, I have met with economic development practitioners from across the Nation, from regions bustling with growth to areas facing serious economic distress.

From these discussions, revolving loan funds have emerged as one of the most effective means for small business development and expansion in rural areas. Locally controlled, these funds provide much-needed capital necessary in many rural areas.

The other thing I would like to point out is that local control includes local elected officials. They are the people that are responsible to the electorate, and I think they are the people who need to be involved in making many of the decisions about who that money

is used within their area as part of the overall economic plan for that area.

EDA has provided funds to establish revolving loan funds in 176 rural areas. Economic development districts have used three EDA-sponsored revolving loan funds to spark small business growth in their communities, but the limited funds are not sufficient to meet the demands.

We in Region Nine have an application pending before EDA to establish our RLF because we were just certified as an EDA district in November, but that will be part of our Economic Development Program. We welcome the availability of additional funds for revolving loan funds from SBA and other sources.

I would like now to comment on the two acts that we are considering today. The Small Business Rural Revitalization Act of 1989 is a sensible approach for capital generation in rural areas. The bill amends existing legislation to facilitate the funding of rural small businesses.

Senator Boschwitz knows that my request has always been for more tools to operate at the local level. This is the most effective way of making development happen. This bill fulfills that request for those of us who are certified development companies. I support its passage.

However, I do believe that certain changes to the current bill will help to make funds more readily available to rural small businesses. The definition of rural areas I think should be changed to be much similar to what it is in the rural SBA and in the Farmers Home rather than in the definition that was given.

The process for determining eligibility is just that. It is a process. I would rather suggest the bill utilize the more accepted and less bureaucratic definition, and the most encompassing definition of rural includes urbanized areas and places with a population of 20,000 or less.

Revolving loan funds fund provision is an excellent means to use existing certified development companies and authorized SBA 504 money to channel funds to rural small businesses in need of capital. That is what I like about this bill personally, that we are using existing funds in the community development or Certified Development Corporation Act, the 504 act, and just changing their use so that those of us at our districts would be able to use them for revolving loans.

However, another thing that I believe is the $100,000 loan size is too restrictive. Many loans in our area particularly would be turned down because our average is getting on to the 200,000 for the SBA involvement in our 504 loans. So we think that we need something similar to that in a revolving loan fund in order for it to be good for us.

Amending the small business investment company language to allow up to 50 percent State or local government or nonprofit participation in the match provides greater flexibility for SBIC formation.

A provision should be added to clarify that pre-existing recycled loan fund money can be used as part of the SBIC match. The $1 million match, however, is still far more than rural areas can gen-

erate. Rural SBICs should provide a $500,000 match, thus making SBIC strategy a more viable one for rural areas.

The Rural Access to Capital Act, or S. 863, I agree with the general concept guiding S. 863, especially its reliance on the revolving loan fund mechanism for delivering funds to rural small business. However, I do have some suggestions for improving the bill as it currently stands.

Eligibility. Eligible applicants must be within rural communities and nonmetropolitan counties not adjacent to metropolitan counties or in metropolitan counties designated by the SBA Administrator.

I think if I take a look at a map of Minnesota, what that does to us in Minnesota, it leaves out of 87 counties only 35 counties eligible. In States like Senator Mitchell's State, there are no eligible counties. The way the definition is written in the present act——

Senator BOSCHWITZ. Do you mean the State of Maine?

Mr. STONE. Yes.

Senator BAUCUS. How about the State of Montana?

Mr. STONE. I cannot answer that. Maybe Aliceann from our staff at NADO can do that, because we have done a map for each State so we have that information available, which we would be glad to get to you.

Senator BOSCHWITZ. I am sure Senator Baucus would like to see that.

Mr. STONE. OK.

As far as coordinated development strategy, there is no coordination for loans to be made as part of an overall community development strategy. One of the strengths that EDA Revolving Loan Fund Program has that the local administrator must submit an annual overall economic development plan. It outlines a comprehensive development strategy for the service area. In our case, that area is nine counties, and that is in conjunction with the applicable local governments.

Thus, the revolving loan fund is capitalized only after taking into account the policies, goals, and objectives established by local and regional plans.

As far as the micro business orientation, title II dedicates one-third of the bill's total funding exclusively for micro businesses. Certainly there is a credit gap in rural America, but this gap is not concentrated in businesses with 15 or fewer employees needing loans of $25,000 or less.

About 5 percent of short-term bank loans that are less than 3 years are under $50,000, while only about 10 percent of the short-term loans are between $50,000 and $500,000.

The credit gap extends to all small business financing; thus, a micro business orientation is too restrictive.

In addition, I firmly believe that any such business targeting should be made at the local level. I think that local elected officials or local officials business and elected are smart enough to make the determination of which businesses should be receiving help.

Should a community or regional plan choose to fund the micro businesses, then they should have the right to do so. However, their community should be allowed the flexibility to use the fund-

ing to provide small business financing to firms which they deem most productive for their communities.

A NADO member in Montana, the Bear Paw Development Corporation located in Havre recently established an EDA revolving loan fund of $700,000. They invested these funds by providing financing for two recently opened manufacturing plants.

In many areas across rural America, micro business is not the answer for creating solid job opportunities and private sector growth. The local communities should be making decisions.

I have serious concerns about title III, the transfer of small business lending company status. This provision should not be approved without further study.

Eligible applicants, we feel, should be expanded to an economic development district which serves a rural community. We feel that economic development district should be expanded to include all multi-jurisdictional regional development organizations including regional councils, councils of Government and similar organizations.

I had a couple of other remarks that I had written down as we were going along, but I will let those go for now, and if they come up in the questioning then I will address them.

Thank you for holding these hearings and for addressing the problems of small business financing in rural areas. Rural America certainly appreciates your leadership in this area. The members of NADO look forward to working with you to pass meaningful rural small business legislation this year.

I will be happy to answer questions.

[The prepared statement of Mr. Stone follows:]

NADO

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Testimony of:

TERENCE F. STONE

Executive Director

Region Nine Development Commission

on behalf of the

NATIONAL ASSOCIATION OF DEVELOPMENT ORGANIZATIONS

Before the

Subcommittee on Rural Economy and Family Farming
of the Committee on Small Business

in the

U.S. Senate

On

Rural Business Development Legislation

June 6, 1989

Washington, D.C.

STATEMENT OF TERENCE STONE, EXECUTIVE DIRECTOR OF THE REGION NINE DEVELOPMENT COMMISSION (MANKATO, MN) AND FIRST VICE PRESIDENT OF THE NATIONAL ASSOCIATION OF DEVELOPMENT ORGANIZATIONS (NADO), BEFORE THE SUBCOMMITTEE ON RURAL ECONOMY AND FAMILY FARMING OF THE COMMITTEE ON SMALL BUSINESS, U.S. SENATE, JUNE 6, 1989.

Mr. Chairman, Mr. Boschwitz, and other members of the Subcommittee on Rural Economy, I am Terence Stone, Executive Director of the Region Nine Development Commission, located in Mankato, Minnesota, and First Vice President of the National Association of Development Organizations (NADO).

I would like to thank you for your interest in improving the flow of capital to small businesses in rural areas. Without adequate financing resources, small business will not be able to survive or expand in rural areas. I commend your efforts in addressing this important issue.

As Executive Director of the Region Nine Development Commission in Mankato, Minnesota and as a former small businessman in a town of 2,200, I am well too familiar with the problems of small business financing in rural areas. Today I am testifying not only from my personal and professional experiences but also as a representative of the National Association of Development Organizations. My comments reflect the concerns of rural development professionals from across the nation.

NATIONAL ASSOCIATION OF DEVELOPMENT ORGANIZATIONS

The National Association of Development Organizations (NADO) was formed in 1967 to maintain and create jobs in small metropolitan and rural communities. NADO's members are substate, multi-county planning and development organizations. These public-purpose institutions are the development professionals who work with local governments and the private sector to promote business, community, and economic development. NADO is the national grassroots network dedicated to improving the economic opportunities and quality of life for all rural Americans.

While "development commission," "regional council," and "economic development district" are not household words, these organizations are an essential part of the institutional infrastructure in rural America. Development commissions are multi-functional; they respond to the varying needs of different local communities by providing a broad range of services. For example, in areas with a large elderly population, commissions focus on providing aging services. Others have strong job training programs to improve the local workforce. Virtually all of these institutions provide small business assistance and development at the local level.

Many NADO members are Small Business Administration (SBA) Certified Development Companies (CDC's) under the Section 504 program. There are over 100 CDC's in rural areas, and the majority of these are multi-county development organizations. The regional approach provides a broad base from which to build a comprehensive small business development program. By pooling the resources within a region, multi-county development commissions can sustain a qualified professional staff to provide small business assistance.

REGION NINE DEVELOPMENT COMMISSION

Region Nine Development Commission serves nine counties and 72 cities in south central Minnesota. Our Commission works with the private sector and local elected officials to coordinate locally-initiated business and community development strategies. We sponsor business training courses for the university-based Small Business Development Center (SBDC) and provide management seminars for both small communities and small businesses. We also conduct training on human service programs vital to our region.

Region Nine is a SBA Certified Development Company. We have participated in the program since its inception. Presently we have approximately 20 loans, which are made in concert with the region's overall economic development plan. We have used the CDC as a means to further the business goals and policies established in our economic development strategy.

THE URBAN-RURAL DISTINCTION

We often hear of a bi-coastal economy, with middle America missing the opportunities for economic growth. I disagree. The true dichotomy is the urban-rural split. Rural America has not kept up with the urban economic expansion. As the Wall Street Journal so accurately noted in an August 4, 1988 article:

> Metropolitan America is wallowing in nervous prosperity. Times are so good that people are afraid they can't last. In the other America, the forgotten one beyond the patches of urban and suburban wealth, people would like the chance to be afraid about good times lasting.

As you know, small business growth in rural areas has been outpaced by such growth in urban areas. The problem is not a lack of rural entrepreneurs but rather inadequate financing resources and management assistance for rural small businesses.

All too often, it seems that rural America has been forgotten as small business financing mechanisms have developed a distinct urban orientation. In some rural areas, reliance on private sector financihg neglects the fact that many of the local banks in rural areas are now owned by holding companies. No longer run by local boards of directors, the banks are run from urban centers hundreds of miles away. These controlling interests have no desire to participate in small business financing in rural areas far removed from their servicing area. Such realities must be addressed if the nation's rural areas hope to prosper and compete in the global economy.

REVOLVING LOAN FUNDS: A MUCH NEEDED INVESTMENT

In my capacity as Vice President of NADO, I have met with economic development practitioners across the nation, from regions bustling with growth to areas facing serious economic distress. From these discussions,

revolving loan funds (RLF's) have emerged as one of the most effective means for small business development and expansion in rural areas.

Locally controlled, these funds provide the much needed capital necessary in many rural areas. The Economic Development Administration (EDA) of the Commerce Department has provided capitalization for revolving loan program for the last 15 years. EDA has provided funds to establish revolving loan funds in 176 rural areas. Economic development districts have used these EDA sponsored RLF's to spark small business growth in their communities, but the limited funds are not sufficient to meet demands. We at Region Nine have an application pending before EDA to establish an RLF as part of our economic development program. We welcome the availability of additional funds for RLFs from SBA and other sources.

"SMALL BUSINESS RURAL REVITALIZATION ACT OF 1989"

The "Small Business Rural Revitalization Act of 1989" (S. 1051) is a sensible approach for capital generation in rural areas. The bill amends existing legislation to facilitate the funding of rural small businesses. Senator Boschwitz knows that my request has always been for more tools to operate at the local level. That is the most effective way of making economic development happen. This bill fulfills that request for those of us who are certified development companies.

I support its passage, however I do believe that certain changes to the current bill will help to make funds more readily available to rural small businesses.

* Eligibility. Eligible rural areas must be designated as such by the Small Business Administration (SBA). This process for determining eligibility is just that -- a process. Rather, I suggest that the bill utilize a more accepted and less bureaucratic definition. The most encompassing definition of "rural" includes unurbanized areas and places with a population of 20,000 or less.

* Revolving Loan Funds. The revolving loan fund provision is an excellent means to use existing certified development companies and authorized SBA 504 money to channel funds to rural small businesses in need of capital. However, I believe that the $100,000 loan size limitation is too restrictive. Many loans would be turned down not because of their feasibility, but because the RLF participation in the deal would require more than $100,000.

* Small Business Investment Companies. Amending the Small Business Investment Company (SBIC) language to allow up to 50 percent state or local government or non-profit participation in the match provides greater flexibility for SBIC formations. A provision should be added to clarify that pre-existing, recycled loan fund money can be used as part of the SBIC match. The $1 million match, however, is still far more than rural areas can generate. Rural SBIC's should provide a $500,000 match, thus making the SBIC strategy a more viable one for rural areas.

"RURAL ACCESS TO CAPITAL ACT 1989"

I agree with the general concept guiding the "Rural Access to Capital Act" (S. 863), especially its reliance on the revolving loan fund mechanism for delivering funds to rural small businesses. However, I do have some suggestions for improving the bill as it currently stands.

* Eligibility. Eligible applicants must be within rural communities in nonmetropolitan counties not adjacent to metropolitan counties or in metropolitan counties designated by the SBA Administrator. This restriction eliminates a vast amount of rural America from eligibility for any funding proposed in this act. As I suggested above, the most encompassing definition of "rural" is unurbanized areas and places with a population equal to or less than 20,000.

* Coordinated Development Strategy. There is no provision that loans are to be made as part of an overall community-regional development strategy. One of the strengths of the EDA revolving loan fund program is that the local administrator of the fund must submit an annual overall economic development plan outlining a comprehensive development strategy for the service area, in conjunction with the applicable local governments. Thus the revolving loan fund is capitalized only after taking into account the policies, goals, and objectives established by local and regional plans.

* Micro-business Orientation. Title II dedicates one-third of the bill's total funding exclusively for micro-businesses. Certainly there is a credit gap in rural America, but this gap is not concentrated in businesses with 15 or fewer employees needing loans of $25,000 or less. About five percent of short term bank loans (less than three years) are under $50,000, while only about ten percent of short term loans are between $50,000 and $500,000. The credit gap extends to all small business financing, and thus a micro-business orientation is too restrictive. In addition, I firmly believe that any such business targeting should be made at the local level, not through a federal mandate. Should a community or regional plan choose to fund micro-businesses, then they should have the right to do so. However, other communities should be allowed the flexibility to use this Act's funding to provide small business financing to firms which they deem most productive for their communities. A NADO member in Montana, The Bear Paw Development Corporation located in Havre, recently established an EDA revolving loan fund of $700,000. They invested these funds by providing financing for two recently opened manufacturing plants. In many areas across rural America, micro-business is not the answer for creating solid job opportunities and private sector growth. The local community should be making such decisions.

* Transfer of Small Business Lending Company Status. I have serious concerns about Title III, the transfer of Small Business Lending Company (SBLC) status. This provision should not be approved at this time. We urge that a careful examination be made of the existing SBLCs and how they should operate and be regulated in the future.

* Eligible Applicant. Among the applicants listed as eligible to receive funds under this bill is "an economic development district which serves a rural community." The term 'economic development district' should be expanded to include all multijurisdictional regional development organizations, including regional councils, councils of governments, and

similar organizations.

Thank you for holding these hearings and for addressing the problem of small business financing in rural areas. Rural America certainly appreciates your leadership in this area, and the members of NADO look forward to working with you to pass meaningful rural small business legislation this year. I will be happy to answer any questions.

QUESTIONS SUBMITTED BY SENATOR GRASSLEY
JUNE 9, 1989 HEARING RECORD

QUESTIONS FOR TERRENCE STONE:

In your testimony you discussed a rural-urban distinction and access to capital from banks with broader based backing. You contend that non-local bank ownership does not have an interest in local development. Could you provide a more expansive explanation of this point? **Do you believe that interstate banking is a disfunction for local development in rural areas?** Would you also be more specific on how you think this "reality" must be addressed in rural development policy?

I discussed the question that you sent me with the NADO staff in Washington. We do not have a position on the effect of interstate banking on economic development in rural areas.

Personally, I feel that the purchase of local rural banks by holding companies or individuals who are not residents of the community has a much larger impact on rural development.

New management may be needed to correct past situations and "clean up" the portfolio of local banks may be necessary. That new managemeht, in many cases, does not have a feel for the community or the people in it. That situation makes it very difficult for some small businesses to get established.

Senator BAUCUS. Mr. Stone, is the Bear Paw Development Corporation a member of your association?

Mr. STONE. Yes, they are.

Senator BAUCUS. Are there any others in the State of Montana who are members?

Mr. STONE. I think they are the only one in the State of Montana.

Senator BAUCUS. I am curious. Is there any reason why others are not members?

Mr. STONE. That is a choice of the local agency about whether they want to be a member or not a member, I guess.

In Minnesota, for example, at one point we were all in, and then because of financial considerations we now have two that are not members. That might be the case with Bear Paw. I am not familiar with their operation.

Senator BAUCUS. What is the major determinant as to whether an association is or is not a member? I am just curious.

Mr. STONE. I think generally what we have been finding this year and last year is it is a financial consideration. They have not been able to——

Senator BAUCUS. What services does the association provide to a member?

Mr. STONE. A great deal of training. We also provide a weekly newsletter that gives us really good insight as far as what happens here in the Washington area. Then we have a very small effective——

Senator BOSCHWITZ. You can put me on that mailing list. [Laughter.]

Mr. STONE. I think some of your staff are.

Senator BAUCUS. What is the fee?

Mr. STONE. It is $1,000 per year. For a sustaining member it is double that, and there are some of us who are sustaining members; but as far as national association membership goes, that is quite reasonable.

Senator BAUCUS. I appreciate that. Associations such as yours clearly can be beneficial.

Mr. STONE. Yes, very definitely.

Senator BAUCUS. I am sorry. I am going to have to leave the hearing. Senator Boschwitz will take over now.

I very much thank you for your testimony.

Senator BOSCHWITZ [presiding]. Before we start with Mr. Palank, could you comment on my question, Mr. Stone, about Section 89 and the minimum wage? I am interested for Senator Baucus to know what your answer will be.

Mr. STONE. I think Section 89, we find, is a problem for some of our smaller businesses; but again, we have many in the case where they have no benefits. For them, it is not going to be a major problem.

Senator BAUCUS. I must say I know Section 89 is a problem. That is the reason we are trying to address it in the Finance Committee.

Mr. STONE. Your staff member, Peter Coyle, was in our community 2 weeks ago and had a hearing on Section 89. We had about 25 people there, and there is a great deal of concern in those small businesses because they really cannot cope with that. The added

expense that even an agency like mine with 20 employees where everybody gets the same benefits, it is just a matter of having that review done. It is going to be a real burden on all of us as far as being a small agency is concerned.

Senator BOSCHWITZ. We would now turn to Mr. Palank.

STATEMENT OF RICHARD PALANK, PRESIDENT, NATIONAL ASSOCIATION OF DEVELOPMENT COMPANIES, WASHINGTON, DC

Mr. PALANK. Thank you. Good morning, Mr. Chairman, Senator Boschwitz, Members of the Subcommittee on Rural Economy, ladies and gentlemen. I want to thank you for the opportunity to appear before you today. My name is Richard Palank, and I am the director of financial services for the St. Louis County Economic Council. I also currently serve as president of the National Association of Development Companies, a member organization of Certified Development Companies nationwide that administers the SBA 504 Loan Program.

Senator BOSCHWITZ. St. Louis County, MN?

Mr. PALANK. No, St. Louis County, MO.

I also serve as president of the Development Company Funding Corporation, which is a sister organization to NADCO and which serves as the fiscal agent for the 504 Loan Program.

Senator, I want to commend you both and Senator Baucus on your efforts to encourage the economic viability of our Nation's rural areas. More needs to be done so that they can participate in our country's overall economic growth and prosperity.

I am particularly interested in the capital formation aspects you address in your respective bills. As I know through my experience as a CDC executive, lack of access to capital is one of the biggest problems for new and expanding small businesses. The revolving loan fund concepts you propose in each bill would provide a much needed source of funds.

Also of interest to me is that both bills target small loans for businesses. These are often the most difficult loans to obtain, particularly for newer companies.

In addition, this need is not currently addressed by any existing Federal program, and the trend in the private sector is moving away from smaller loans.

Before I comment on some of the specific provisions of the rural development bills, I would like to take a few minutes and make a couple of remarks about the structure and experience of SBA Certified Development Companies and why they are in a special position to assist with and participate in the rural development effort.

As you well know, the Certified Development Companies administer the SBA 504 Loan Program nationwide which, of course, is long-term fixed asset, fixed-rate financing program. CDCs are not-for-profit companies for the most part. They are represented by boards of directors which by law require broad community representation. By statistics from the SBA, approximately one-third of all development companies are rurally located.

The success of Certified Development Companies has been reflected in the success of the 504 Program.

Just to give you a quick summary, as you well know, the program is successful not only because of its substantial leverage of private capital, but also the program has been responsible for the creation of approximately 100 new jobs over the past 10 years and is well known for the low default rate which is currently, I believe, about 3 percent and a little bit higher.

I would like to now focus on the capital formation aspects of S. 863 and S. 1051, particularly the proposal to make loans available to small rural companies.

First, NADCO fully endorses this objective. Our industry experience indicates that financing in any form is more difficult in rural areas due to the generally conservative nature of banks relative to small business lending.

Senator BOSCHWITZ. You are not following your testimony that you submitted to us.

Mr. PALANK. I am trying to skip over some of it, but I am going to start following pretty closely. I am on the capital formation objective, and I will follow pretty closely from here on out. I am trying to skip over some of the words and summarize.

In many areas the private sector has totally abandoned making small commercial loans to small or startup companies. We feel this is a serious need that is not currently addressed in an effective way by the private sector or any Federal program.

We do have a couple of concerns about each of the bills, and I would just like to make a reference to each of those.

With respect to S. 1051, the bill calls for the sale of debentures followed by small loans by certified development companies to small business concerns. We are concerned that the negative arbitrage potential of this could be a cause of difficulty for the Certified Development Companies delivering the system.

However, I would like to note we are working with your staff in correcting any of these potential problems to make the program more usable.

Quickly, with respect to S. 863, we would like to make sure that those enterprises that administer the loan program have the expertise and background in making qualified loans such as the CDCs do with the 504 Loan Program.

Now I will go back to the prepared statement.

Moving from my discussion of the Revolving Loan Program to the provisions on the transfer of the SBLC license, I would like to emphasize that NADCO formed a rural task force 2 years ago at SBA's reqeust to make recommendations on ways CDCs could further stimulate economic development in rural areas.

The recommendations were directed at two areas: First, regulatory reform of the 504 Program, which has been mentioned earlier; and second, increasing access to the 7(a) Loan Program in rural areas.

Regarding 7(a) Loan Program access, NADCO has been involved in ongoing negotiations for over 1 year to acquire an inactive nonbank lender license for the purpose of creating an entity through which CDCs could offer the 7(a) Program to borrowers.

A recent survey of our membership confirms that the two primary uses of a CDC nonbank lender would be to offer the 7(a) Program in those rural areas where the 7(a) Program is underpresent-

ed and for small loans in all areas because such loans are very difficult to obtain.

Over 50 percent of our membership or 103 CDCs approximately responded to the survey. Of that number, over 90 percent said they had the capability and desire to make use of a CDC nonbank lender. Over half of the respondents indicated that they would make a minimum of one-third of their loans in rural areas, while one-third of the respondents expect to make at least one-half of their loans in rural areas.

We strongly support the provision in Senator Baucus' bill which would direct the agency to transfer an inactive license to a qualified applicant. Enactment of this provision would permit us to conclude the negotiations which have been ongoing for over 1 year, as I mentioned.

Through our nationwide CDC network, a NADCO affiliated nonbank lender would help to ensure that more of the 7(a) dollars being spent go to areas where access to capital has previously been limited at best.

We understand that the Small Business Administration testified in opposition to this provision at a recent hearing in Montana, indicating that the agency lacks the resources to regulate and monitor additional lenders which are not subject to regulation and supervision by other Federal or State authorities. We understand and appreciate the agency's position and have indicated our willingness to work with the SBA to address this issue.

One alternative we have suggested is to develop a method of compensation that will not increase the cost of oversight to the Federal Government. We believe that a solution can be worked out which will address the agency's concerns while meeting the greater need for additional financing vehicles in rural areas.

Regarding your provision on job cost requirement, Senator Boschwitz, NADCO has for the past 2 years pursued a number of changes to the 504 Program which would benefit the overall program, including its operation in rural areas.

For example, we are concentrating on the job/cost ratio of one job per $15,000. We recently commissioned a study by Arthur Anderson and Company on the cost of creating a job in today's economy. Preliminary indications are that the cost is many times higher than the 504 Program requires.

This requirement has had the effect of greatly restricting the use of the program in rural areas. NADCO supports the provision in your bill which would raise the requirement for rural areas to one child per $30,000.

I would like to thank you for the opportunity to address this hearing. NADCO has worked closely with the Subcommittee in the past to meet the challenges of providing small business financing through creation of the 504 Program, and I commend you for your current efforts on behalf of rural Americans.

NADCO's nationwide network stands ready to assist in putting these provisions to work.

[The prepared statement of Mr. Palank follows:]

NADCO
National Association of Development Companies

STATEMENT ON S. 863, S. 1051

concerning Rural Development

before the

SENATE SUBCOMMITTEE ON THE RURAL ECONOMY

by

RICHARD PALANK

JUNE 9, 1989

1730 Rhode Island Avenue, North West, Suite 209 Washington DC 20036 (202)785-8484

Good Morning, Mr. Chairman, Senator Boschwitz, Members of the Subcommittee on the Rural Economy, ladies and gentlemen. I want to thank you for the opportunity to appear before you today.

My name is Richard Palank and I am the Director of Financial Services of the St. Louis County Economic Council. I also serve as the President of the National Association of Development Companies, known as NADCO, representing Certified Development Companies that lend money to qualified small businesses under the SBA 504 loan program, and as the President of the NADCO affiliate Development Company Funding Corporation, which acts as the fiscal agent for the 504 industry.

Senator Baucus, I want to commend both you and Senator Boschwitz on your efforts to encourage the economic viability of our nation's rural areas. More needs to be done so that they can participate in our country's overall economic growth and prosperity.

I am particularly interested in the capital formation aspects you address in your respective bills. As I know through my experience as a CDC executive, lack of access to capital is one of the biggest problems for new and expanding small businesses. The revolving loan fund concept you propose in each bill would provide a much-needed source of funds.

Also of interest to me is that both bills target small loans for businesses. These are often the most difficult loans to obtain, particularly for newer companies. In addition, this need is not currently addressed by any existing federal program, and the trend in the private sector is moving away from smaller loans.

CDC Role in Expanding Economic Development

Before I comment on some of the specific provisions of the rural development bills currently being developed, I would like to make some brief remarks about the structure and experience of SBA-Certified Development Companies and why they are in a special position to assist with and participate in the rural development effort.

The SBA's 504 loan guarantee program is implemented through a nationwide network of development companies certified by the Small Business Administration. The 504 loan program is a fixed asset financing program for expanding small businesses. It is the first federal financing tool to target small business job creation through physical plant expansion.

Certified Development Companies are local public/private partnerships organized as non-profit community-based corporations regulated and licensed by SBA to provide 504 financing to local small companies. There is a nationwide network of approximately 200 active CDCs that are well-represented in rural areas -- SBA data indicates that over one-third are rural CDCs. Industry efforts are currently underway to expand their rural area coverage.

CDCs are staffed with professionals who work directly with small businesses. The staffs market, package, process, close and service 504 loans. In addition, most rural CDCs offer and implement other economic development programs in their areas of operations, and are knowledgable about federal and state resources available in rural areas.

CDCs currently make SBA 504 economic development loans in which each project works with the private sector to leverage a minimum of 60% of private capital. As a result, active CDCs know the SBA programs, as well as the private sector lending environment.

With the 504 program, CDCs arrange financing for small companies wherein:

* each project leverages substantial private capital
* each project contributes to the local economy: over 100,000 jobs have been created or retained nationwide
* the program is delivered through nonprofit entities, maximizing the benefits which reach the borrower
* the 504 program's $1 billion-plus portfolio has the lowest default and loss rate of any federal loan guarantee program

We believe that these characteristics give the industry a good perspective from which to comment on the current efforts to encourage rural development.

The Capital Formation Objectives

Both revolving loan fund proposals and the "Microbusiness" loan fund target the provision of loans in rural areas.

NADCO fully endorses this objective. Our industry experience indicates that financing in any form is more difficult in rural areas due to the lack of infrastructure and the generally conservative nature of banks relative to small business lending. In many areas, the private sector has totally abandoned making small commercial loans to young or small companies. We feel that this is a serious need that is not currently addressed in an effective way by the private sector or any federal program.

The Specifics of the Capital Formation Provisions

NADCO does have some concerns regarding certain provisions of each revolving loan fund. S. 1051 would permit qualified CDCs to sell debentures in the monthly 504 offering to finance a revolving loan fund to make small loans in rural areas. NADCO supports this concept. However, the nature of the current 504 debenture offering, which is based on previously-approved loans, would preclude the inclusion of a debenture to fund a revolving loan fund. Some restructuring would be necessary. We also have concerns about a model that would result in CDCs holding undisbursed debenture funds while seeking qualified borrowers. This could have a significant adverse impact on CDCs, which are largely non-profit entities.

Let me emphasize, however, that we support the concept of the provision. At the request of Senator Boschwitz's office, we have suggested changes which address these issues and submitted it to the Senator's staff for review.

S. 863 proposes to administer a revolving loan fund through a number of eligible applicants, including CDCs. We do feel that it is important to protect the integrity of the program by ensuring that the loans are made available through entities which have proven credit analysis and loan servicing capabilities in small business loans. A CDC, which is required to have a community-wide base and demonstrate this capability, is one ideal choice for implementing the objectives of the revolving loan fund. Even if CDCs are only one of a number of vehicles delivering the loan fund, we think it is important that eligible users have proven lending and loan servicing capabilities.

In addition, both revolving loan fund programs envision a requirement to leverage a substantial amount of private capital into each project. While this is a laudable goal that CDCs accomplish daily in the 504 program, we are concerned that this requirement will make the fund more difficult to use, and in some cases will render it unusable.

Baucus Provision on Transfer of SBLC License

Two years ago, NADCO formed a Rural Task Force at SBA's request to make recommendations on ways CDCs could further stimulate economic development in rural areas.

The recommendations were directed at two areas: regulatory reform of the 504 program and increasing access to the 7(a) loan program in rural areas.

Regarding 7(a) loan program access, NADCO has been involved in ongoing negotiations for over a year to acquire an inactive nonbank lender license for the purpose of creating an entity through which CDCs could offer the 7(a) program to borrowers. A recent survey of our membership confirms that the two primary uses of a CDC nonbank lender would be to offer the 7(a) program in those rural areas where the 7(a) program is underrepresented, and for small loans in all areas, because such loans are very difficult to obtain.

Over 50% of our membership responded to the survey. Of that number, over 90% said they had the capability and desire to make use of a CDC nonbank lender. Over half of the respondents indicated that they would make a minimum of one-third of their loans in rural areas, while one-third of the respondents expect to make at least half of their loans in rural areas.

We strongly support the provision in Senator Baucus' bill which would direct the Agency to transfer an inactive license to a qualified applicant. Enactment of this provision would permit us to conclude the negotiations which have been ongoing for over a year. Through our nationwide CDC network, a NADCO-affiliated nonbank lender would help to ensure that more of the 7(a) dollars being spent go to areas where access to capital has previously been limited, at best.

We understand that the Small Business Administration testified in opposition to this provision at a recent hearing in Montana, indicating that the Agency lacks the resources to regulate and monitor additional lenders which are not subject to regulation and supervision by other federal or state authorities.

We understand and appreciate the Agency's position, and have indicated our willingness to work with SBA to address this issue. One alternative we have suggested is to developa method of compensation that will not increase the cost of oversight to the federal government. We believe that a solution can be worked out which will address the Agency's concerns while meeting the great need for additional financing vehicles in rural areas.

Boschwitz Provision on Job/Cost Requirement

In the past two years, NADCO has pursued a number of changes to the 504 program which would benefit the overall program, including its operation in rural areas. For example, we are concentrating on the job/cost ratio of one job/$15,000. We recently commissioned a study by Arthur Andersen & Company on the cost of creating a job in today's economy. Preliminary indications are that the cost is many times higher than the 504 program requirements. This requirement has had the effect of greatly restricting the use of the program in rural areas. NADCO supports the provision in Senator Boschwitz's bill which would raise the requirement for rural areas to one job/$30,000. Based on the results of the study, we would also support raising the standard outside of rural areas to one job/$25,000.

Thank you for the opportunity to address this hearing. NADCO has worked closely with the committee in the past to meet the challenges of providing small business financing through creation of the 504 program, and I commend you for your efforts on behalf of rural Americans. NADCO's nationwide network stands ready to assist in putting these provisions to work.

Senator BOSCHWITZ. I thank all of you, and I thank Mr. Palank. Perhaps you would respond to questions. I would ask that Mr. Kangas come back and also Mr. Doose. If you would come back up, I would ask all of you a few questions and pursue some of the questions that do not relate entirely to what we are doing.

Mr. Jackson, do you have a statement?

Mr. JACKSON. No, not a written statement. I do have an oral statement I was prepared to give, but I have not filed a typewritten statement.

Senator BOSCHWITZ. Pardon me. I did not realize that. Please give your statement.

STATEMENT OF JOHN JACKSON, GENERAL COUNSEL, MINNESOTA BANKERS ASSOCIATION, MINNEAPOLIS, MN, ON BEHALF OF THE AMERICAN BANKERS ASSOCIATION

Mr. JACKSON. I will be very brief.

Senator BOSCHWITZ. Pardon me. I thought you had come with Mr. Stone and was sitting there in support. He often needs a good deal of support. [Laugher.]

As you saw, he is always turning to his staff. I have known him for many years.

Mr. STONE. I always do that.

Mr. JACKSON. Well, for the record, Senator Boschwitz, my name is John Jackson, and I serve as general counsel for the Minnesota Bankers Association and appreciate the opportunity to be here and fully support the work of this Subcommittee.

Rural economic development is very much on the minds of our members, so much so that 3 years ago our association created a C3 foundation specifically for the purpose of assisting our members to understand and reach and help to assist their own communities in arriving at effective economic goals.

We found, for example, that our members were not up to snuff on a variety of Federal programs and State programs that are available to assist communities. Part of our foundation's job is to develop the kind of clearinghouse for that kind of information.

Part of your bill, S. 1051, calls for every examination of Federal regulations to make sure that there is a simplification, that there is a further understanding, less duplication, and that is a valid point. In that bill, in fact, our association supports your legislation.

The Revitalization Act, S. 1051, we see as a partnership between the private sector and the SBA in assisting Minnesota, rural America, in a very important and crucial challenge.

One of the things that I wanted to bring to the Subcommittee's attention was the fact that in Minnesota our bankers needed a tool or wanted a tool to respond directly and more effectively to the economic needs of communities that have been in economic stress, small businesses that have in our State experienced in the past 3 years significant economic stress where their principal economic support is from the agricultural sector.

We needed a tool, and we found a program that was implemented in Michigan about 2½ years ago. That program has no specific legislation. There is no specific regulation but was nevertheless developed by an agency in Michigan. We learned a lot from Michigan

bankers about that program. We prepared legislation and introduced legislation in Minnesota. We called it the Minnesota Capital Access Program.

We are very pleased to see that you, Senator Boschwitz and Senator Lugar, have introduced similar legislation, the Rural Capital Access Program, in separate legislation in the Congress which we feel—and I guess it is my primary purpose for being here—that the Senate should take a hard look at. It gives financial institutions, subject to safety and soundness regulations, nevertheless an opportunity with minimum of bureaucratic interference and bureaucratic overlay to respond to the economic needs of the community where slightly riskier loans are involved.

It is not a panacea, but it does give us an extra tool to, as we see it, make some loans we would not otherwise be able to make.

That legislation, which is very similar to the legislation that you are sponsoring and have introduced in the Congress, was supported wholeheartedly in Minnesota, both sides of the aisle. The concept was greeted enthusiastically; highly leveraged funds, State funds, 17 or 18 to 1, in terms of loans to State funds involved.

I regret to report to you that that legislation was vetoed by our Governor not because he had a problem with the concept but because he had a problem with house leadership in Minnesota and the way the bill was funded.

I think for the record it should be noted that that bill which you are author of had received hearings in both the house and the senate in our State and was very well received. I would urge that if at all possible, the Senate Subcommittee should take a good hard look at the Rural Capital Access Bill.

Senator BOSCHWITZ. That is over in the Agriculture Committee. I do like that legislation. Obviously I did not realize it was vetoed by the Governor.

Was it a freestanding bill, or was it part of the general tax legislation?

Mr. JACKSON. It was part of a State Department Bill where he has line item veto authority, and he vetoed the funding mechanism that was in the State Department Bill. So in effect we have legislation but no funding.

Senator BOSCHWITZ. Here I am supporting line item veto over here, but it sometimes operates to our detriment.

Well, I thank you, too, for your testimony, Mr. Jackson. Pardon me for assuming that you were here in support of one of the other witnesses.

Let me pursue with all of you gentlemen just a little bit more the interesting question aside from this hearing. I might say that I asked my staff director, Peter Coyle, who some of you know, to come in because I wanted to say that I found the testimony particularly valuable this morning not only from you gentlemen but from the Small Business Administration as well.

Interestingly, it had the aspect of actually being directed at the legislation at hand. So often people come in and make general statements, and all of you have tried to address the legislation that we are considering with a high degree of specificity. I thank you for that. That will be very helpful, and we will really review that carefully.

I sometimes find as you have alluded, Mr. Jackson and some of you others as well—that we pile legislation upon legislation. You come up with a new idea, and you come up with a new bill, and all is going to be well if we can only legislate this one thing. That does not mean that one should preclude new ideas because good new ideas do come up, but all of the other stuff stays in.

With some of the bills in rural development coming forward now, the structures get a little complex in my judgment, but I appreciate your testimony this morning.

Let me talk about the interesting issue that came up about the medical programs available for employees or the types of additional compensation other than compensation itself. The benefit plans in general. In the small companies that you oversee, very often they do not have it.

I am concerned that these people apparently are among the 37 million people who are uninsured in the United States in one way or another, so let me ask a series of questions.

How can we resolve that? Should it be resolved? Should we attempt to cure it? I think it is pretty necessary that every family have some kind of medical coverage; otherwise, they are putting themselves at very high risk in my judgment.

Furthermore, one of my problems is that if there are enough people around who do not have medical coverage, we are going to have a lot of pressure in this institution and here in Washington to have a form of national medical care, socialized medicine as it is called often. I would like to avoid that if I could.

I would be interested in listening to your experiences with respect to benefit programs and medical coverage more specifically and what we can do or what you think we should do to provide broader medical coverage.

Do you find that the people who work for these small businesses often have medical coverage through their family from other sources?

I address that to you as a whole and invite any of you to answer that.

Terry, why not start off. What is your experience in the companies that you have financed over a period of time? Most of those people do not have medical coverage?

Mr. STONE. Well, most of the smaller companies probably do not have medical coverage, and they probably do not have any other benefit programs, either. Then even some of the larger companies in the area, we have a couple of counties that are complaining because they do not have enough people to work.

Rudy, you are fully aware of that because you have heard from them on a continual basis.

The problem is that the kind of business they are in does not return them enough, and this is primarily processing companies, processing chicken or other meat products. Where they are actually further processing that, they pay minimum wage basically. In Minnesota, minimum wage is higher than the Federal minimum, whatever it is, $3.75, $3.80 per hour. That is what those people start at. Their big selling point in their ads is by the time you have been here 3 years you will get up to $5 per hour or $5.25.

Now even in south central Minnesota it is impossible for a family to live on that. Now, they may provide limited medical benefits, but then we have the other one, two, three employee companies that have none. So it is a very real problem, and I do not know if better return for our product would take care of a lot of those things.

You know, like they always say the way to solve the farm problem is to get $5 bushel for corn, it is kind of like the same thing, I think, with the small companies. If we had a better return for the products that those companies produce, they would be able to give those benefits.

We know many of those companies could not survive if they had to at least under the accelerating medical insurance costs—I mean, for my agency, for example, to insure me just because of my age under a family coverage, it is about $300 per month. Now that is a pretty good benefit for me but a pretty heavy burden for the organization. I think you find that same thing in any small company.

You start taking $3,600 a year out of a two-or three-person company for insuring one of their members, it is a real problem. I do not have the solution.

Mr. KANGAS. I think it goes back to the productivity issue that Terry brings up. Can the workforce in rural areas, given the amount of technology and capital and entrepreneurial ability that is out there, generate a sufficient rate of return to cover what we might think is a normal expense?

The fact is that the productivity marginal product of each individual worker is not sufficiently high to deal with that issue. The alternative would be to set up some sort of medical assistance or medical insurance program that spreads the risk appropriately and can be very efficiently administered. I do not know if that is realistic or not.

So those are the only two choices.

Senator BOSCHWITZ. Most of the companies that your group is involved with do not insure their employees?

Mr. KANGAS. I would say that is the case. They do not.

Senator BOSCHWITZ. Does the insurance, just as a matter of interest, that your own organization provides you cost as much as it costs in Terry's case?

Mr. KANGAS. Well, my financial people tell me it costs $291 per employee with a family for family coverage.

Senator BOSCHWITZ. You, too?

Mr. DOOSE. I am in the same situation, yes. I agree that the solution is not to require that all companies that have more than X number of employees provide health insurance to their employees as a matter of legislative mandate, for example. That would have a disproportionately negative effect on the rural economy. Most of the jobs lost as a result of that requirement would occur in rural areas.

I do not like national health insurance any better than anybody else in all likelihood, but it is probably a reality that if as a matter of public policy we choose to address the issue it will have to be addressed from the point of view of how can you generate a volume of resources sufficient to address the problem without creating windfalls and wipeouts among the business enterprise, and that

means you are going to have to reallocate resources at the Federal level somehow.

Mr. JACKSON. I could only comment on the reverse of what we have heard. Our members provide benefits. The cost, however, of complying with Section 89 as originally introduced and the regulations require in terms of whether or not it passes the discriminatory test is so prohibitive that we hear statements like, well, we are just not going to offer benefits, we will just suspend offering benefits if it is going to cost this much in order to find out if we comply.

There is a great need at least for simplification if nothing else.

Senator BOSCHWITZ. Of Section 89?

Mr. JACKSON. Section 89.

Senator BOSCHWITZ. I heard the argument on the Floor very eloquently put the other evening by Senator Packwood who I greatly admire that while those kind of comments were made at the time that ERISA came in and that if we made these requirements on retirement plans that simply the retirement plans would fold and would not be offered, and on and on.

He then said that that just has not been the experience; that the requirements were put into effect, and the retirement plans have mushroomed.

On the other hand, I would gather that your people do not have medical insurance, that very, very few of them have retirement plans, if any. So I am not sure that it is analogous.

My response was that medical plans are broader in application than retirement plans. For instance, do your banks offer retirement plans to their employees?

Mr. JACKSON. That is my understanding when the health benefits are offered.

Senator BOSCHWITZ. I do not know the rules, but can you offer the president and vice president a retirement plan and not offer it to the tellers?

Mr. JACKSON. I know with respect to 401Ks that there are certain discriminatory rules that apply to all employees, and you cannot be discriminatory with respect to key employees.

Senator BOSCHWITZ. The lady behind you is shaking her head. Does that mean she knows something about this? If you do, just identify yourself for the reporter.

Ms. WALLBROOK. I am Allison Wallbrook, the executive director of NADO. I came with Terry, Senator, but I know for our little association which has a staff of three that we have been told we cannot provide any benefits to just one in terms of pensions; that all three of us have to have the same type of benefits. So that is what we have.

Senator BOSCHWITZ. Those are among the many difficult problems that we face.

Are there any other comments that any of you would like to make? Otherwise I think we will draw this hearing to a close.

Any other comments?

Mr. KANGAS. I would like to make one. It involves your bill as far as analyzing all of the various Federal programs. I would encourage that because as you probably reflect each day upon what you have done and perhaps the Government can take a look at

what it is doing even if it is every 10 years. That would not be too often.

Senator BOSCHWITZ. Well, I tell you. We tried to put together for our Minnesota companies and people such as yourself a book about all the Government plans that were available, and I think we got it done but it was a massive job.

So I very much understand your comment, Mr. Jackson, that you found your members were not conversant with what was available to them. I must tell you that many of us really are not so conversant with what is available to us even on the Federal level without guessing what is available on the State and local level.

So making an inventory of all of that I have discussed on a number of occasions, as recently as yesterday when the director of the Congressional Budget Office came to see me.

You know, we have agencies to oversee agencies, and so forth, and the massiveness of it and the inter-relationship of it, some of which you all touched on today, the definition of rural for instance, I think that we were very much helped by your comments on that today. It is awesome.

Mr. STONE. Senator, for the record I have the map of Montana, and there are 42 eligible counties and 14 that are not eligible. So they are in much better shape than Minnesota and in considerably much better shape than Maine.

Senator BOSCHWITZ. Well, Senator Baucus' staff director is still with us, and if you can spare that map or perhaps we can make a photograph of it, I am sure that he would be interested in seeing it.

Mr. STONE. Then your original comment this morning about trying to work this out with the Chairman of the Agriculture Committee, I think that would be very good if we could get these bills rolled into that Agriculture Committee bill. I think that one looks like it has a fairly good chance of clearing the Senate, does it not?

Senator BOSCHWITZ. Yes. I believe, Terry, that is going to be the vehicle. So we are negotiating around with the Chairman of the Agriculture Committee. We do not want our efforts subsumed in the efforts of the Agriculture Committee. We want just for the sake of our own perhaps ego or independence of our Subcommittee to seem to have a role in it.

So we will attempt to do that, but we will attempt also to see that the train does not leave the station without our being on board.

Well, thank you very much. This hearing is adjourned.

[Whereupon, at 12:05 p.m. the hearing was adjourned.]

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